IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

No. 79-791

CONSOLIDATED GAS SUPPLY CORPORATION,

Petitioner,

v.

FEDERAL ENERGY REGULATORY COMMISSION
and
PUBLIC SERVICE COMMISSION OF THE
STATE OF NEW YORK,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Consolidated Gas Supply Corporation prays that a writ of certiorari issue to review the judgment and order of the United States Court of Appeals for the District of Columbia Circuit, entered on July 10, 1979, dismissing its petition to review orders of the Federal Energy Regulatory Commission.

ORDERS BELOW

The orders of the court of appeals are unreported and are reproduced in full in Appendix A. The orders of the Federal Energy Regulatory Commission are unreported and are reproduced in full in Appendix B.

JURISDICTION

The court of appeals entered judgment on July 10, 1979, and denied a timely petition for rehearing on August 22, 1979. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTION PRESENTED

Whether the United States Court of Appeals for the District of Columbia Circuit abdicated its responsibility to require the Federal Energy Regulatory Commission to adhere to the standards established in *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944), and *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n.*, 262 U.S. 679 (1923), and to comply with the standards of the Natural Gas Act and the agency's regulations.

STATUTORY PROVISIONS INVOLVED

The relevant provisions of the Natural Gas Act, 15 U.S.C. § 717, *et seq.* (1977), and the Federal Energy Regulatory Commission Rules of Practice and Procedure, 18 C.F.R. §§ 1.18 and 1.30 (1979), are set forth in Appendix C.

STATEMENT OF THE CASE

This case involves two critically important issues that affect the ability of federally regulated utilities to maintain financial integrity and to attract necessary capital. The first issue is the appropriate standard against which a fair rate of return is to be measured. The second is the agency procedures under which that standard is to be applied.

The genesis of the dispute in this case was the filing by Consolidated Gas Supply Corporation ("Consolidated"), a natural gas company subject to the jurisdiction of the Federal Power Commission ("Commission"),[1] for three consecutive rate increases. The first became effective, subject to refund, on December 1, 1973, and remained in effect until December 1, 1974. The second became effective, subject to refund on December 1, 1974, and remained in effect until November 1, 1975, when the rates in the third filing became effective.

Administrative proceedings on the three rate increase filings were in progress, but not completed, when, on or about May 3, 1976, Consolidated received a letter from John G. Lotis, then Assistant General Counsel of the Commission.[2] The letter recited:

> The Commission has determined that the resolution through settlement of the . . .

---

[1]As used in this Petition, the term "Commission" shall mean the Federal Power Commission until October 1, 1977, and the Federal Energy Regulatory Commission thereafter.

[2]The letter was undated but was received by Consolidated's counsel, John E. Holtzinger, Jr., on or about May 3, 1976.

> proceedings is in the public interest. Therefore pursuant to Section 1.18 of the Commission's Rules of Practice and Procedure, Consolidated . . . is hereby requested to submit to the Commission and serve on all parties ... an offer of settlement . . . .
>
> The offer of settlement should be documented by cost and other available information by which the justness and reasonableness of the settlement offer can be determined.[3]

At the time that the letter was received, adjudicatory hearings had been completed, and briefs had been filed to the Presiding Administrative Law Judge as to the first two rate filings. With respect to the third filing prepared testimony had been filed but the hearing had not commenced.

On August 6, 1976, approximately three months after having received Mr. Lotis' letter, Consolidated filed a unilateral settlement proposal. On August 9, 1976, the proposal was certified to the Commission.

The proposal was filed under, and specifically incorporated, the section of the Commission's regulations which protects, as privileged, unaccepted offers of settlement.[4] Among other things, the proposal set forth

[3]Joint Appendix, filed in D.C. Cir. at 669.

[4]The Commission's regulations at 18 C.F.R. § 1.18(e) provide:

> *Offers of settlement.* Nothing contained in this section shall be construed as precluding any party to a proceeding from submitting at any time offers of settlement or proposal of adjustment to all parties and to the Commission . . . or from requesting conferences for such purpose. Unaccepted proposals of settlement or of adjustment or as to procedure to be followed and proposed stipulations not agreed to shall be privileged and shall not be admissible in evidence against any counsel or person claiming such privilege.

Appendix C at A-74.

the rate of return on equity that Consolidated would be willing to accept in settlement of each of the dockets.[5] The proposed equity allowances were contested by the staff of the Commission and one intervenor, the Public Service Commission of the State of New York.[6]

On July 5, 1977, the Commission issued its order rejecting Consolidated's proposal on the rate-of-return issue. *Sua sponte,* and without the benefit of either an initial decision or briefs to the Commission, the Commission "prescribed" a rate of return on common equity of 11.75 percent in the first two dockets and 12.30 percent in the third docket.

Consolidated sought rehearing, arguing that (1) the Commission had departed from the long-established legal standard for determining a fair rate of return, (2) the Commission had failed to adhere to its regulations regarding unaccepted offers of settlement, and (3) the Commission's order was the epitome of unreasoned decision-making -- its order on rate or return being internally inconsistent.[7]

[5]The proposal offered, in the first docket, an overall rate of return of 9.46 percent, yielding a 12 percent return on common equity. In the second docket, Consolidated offered to accept an overall rate of return of 9.59 percent, yielding a 12.25 percent return on common equity. As to the third docket, Consolidated proposed to receive an overall rate of return of 10.50 percent, yielding a 13.58 percent return on common equity.

[6]Because the Commission uses the actual embedded cost of debt and preferred capital in determining the overall return, the return on equity is the crucial issue to the regulated company and the consumer.

[7]Appendix B at A-38,39 and A-46.

On August 8, 1977, the Commission's Secretary issued an "Errata Notice" to purportedly correct certain of the most glaring inconsistencies in the Commission's order. On August 29, 1977, the Commission denied rehearing of its rate of return order in the first two dockets but remanded that issue to the Presiding Administrative Law Judge in the third docket.[8] Consolidated then sought review of the Commission's orders in the United States Court of Appeals for the District of Columbia.

In an opinion filed on July 10, 1979, the D.C. Circuit dismissed Consolidated's petition for review, concluding that, despite the internal inconsistencies in the Commission's order, the Court could discern the path which the Commission followed; and that although the Commission had improperly used a privileged settlement proposal as evidence against Consolidated, the error was harmless because other evidence existed to support the Commission's order.

Because of the D.C. Circuit's failure to require the Commission to adhere to the proper legal standard for determining rate of return, and because the D.C. Circuit erroneously concluded that evidence other than the settlements supported the Commission's selection of an 11.75 percent return on common equity, Consolidated sought rehearing. Consolidated explained to the court that (1) apart from the settlement proposal there was no evidence to support the Commission's prescribed rate of return, the D.C. Circuit's "translation" of equity returns being wrong and unsupported by the record; and (2) the Commission's orders departed drastically from the standards of *FPC v. Hope Natural Gas Co.*, 320 U.S. 591

[8]Appendix B at A-62.

(1944) and *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n.*, 262 U.S. 679 (1923).

On August 22, 1979, the D.C. Circuit denied Consolidated's petition for rehearing and suggestion for rehearing *en banc*.

REASONS FOR GRANTING THE WRIT

The Court should grant certiorari for the following reasons:

1. The D.C. Circuit's opinion abdicates the standards established in *FPC v. Hope Natural Gas Co., supra*, and *Bluefield Waterworks & Improvement Co., v. Public Service Comm'n., supra.*

2. The D.C. Circuit's Opinion Emasculates the Substantial Evidence Standard.

3. The D.C. Circuit's opinion disregards the fundamental requirement established in *SEC v. Chenery Corp.*, that agencies state the reasons for their decisions.

1. The D.C. Circuit's Opinion Abdicates The Standards Established in *FPC v. Hope Natural Gas Co.* and *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n.*

Petitioner was clearly entitled to have its rate of return determined according to the standards established by the Court in *FPC v. Hope Natural Gas Co., supra* and *Bluefield Waterworks & Improvement Co. v. Public Service Comm'n., supra.* Instead, the D.C. Circuit permitted the Commission to prescribe a rate of return for a public utility, not by reference to the comparable earnings and attraction of capital test, but by reference *solely* to the utility's equity ratio.

In *FPC v. Hope Natural Gas Co., supra,* this Court explained:

> [T]he return to the equity owner should be commensurate with returns on investment in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and attract capital.[9]

This two-pronged test was ignored by the Commission. Instead, the Commission based its decision entirely upon a miscalculated comparable earnings test, ignoring completely the attraction of capital test. The standards established by this Court require that the rate of return be (a) comparable to the rates earned by other companies having similar risks, and (2) sufficient to permit the company to attract capital.

[9]320 U.S. at 603.

Specifically, the Commission refused to apply this Court's second test by ignoring record evidence which showed that (1) Consolidated's earnings-price ratio showed a definite and significant increase in the cost of equity capital; (2) the Commission staff's own witness demonstrated that, in each of the years shown on his exhibit, Consolidated fared worse than the listed industries and utilities; (3) the dividend yield plus dividend growth studies performed by Consolidated were evidence of the fact that Consolidated's cost of equity capital had increased; and (4) Consolidated's common stock sold well below book value. The Commission, instead, relied almost entirely on the fact that Consolidated's capital structure showed a higher equity ratio than other pipelines, and ignored the record evidence.

This is not the test established by this Court in *Hope* and *Bluefield* -- the standards against which Consolidated was entitled to have its rate of return determined.

2. The D.C. Circuit's Opinion Emasculates The Substantial Evidence Standard.

Section 19(b) of the Natural Gas Act, 15 U.S.C. § 717r(b) provides, in pertinent part:

> The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.

A Commission decision which is not based on substantial evidence may not be upheld. *Permian Basin*

Area Rate Cases, 390 U.S. 747, 792 (1968). Here, the Commission's decision was based upon no record evidence.

Typically, the overall rate-of-return is determined by computing the historic or embedded cost of debt and preferred stock as of the time period for which the rates are to be determined. Here, the Commission used Consolidated's adjusted capital structure as of December 31, 1974, which it summarized as follows:[10]

Preferred Stock	Amount	Ratio	Cost	Return Component
Long-Term Debt	$575,384,000	44.22	6.35	2.81
Preferred Stock	50,000,000	3.84	10.96	.42
Common Equity	675,694,000	51.94	[11.75]	[6.10]
		100.00		[9.33]

It then concluded that a return on common equity of 11.75 percent, or an overall return of 9.33 percent, should be prescribed in both of the dockets at issue. The Commission's orders disclose that the rate of return was determined, not by reference to the record evidence and the application of the appropriate standards, but by selecting a figure which fell somewhere between Consolidated's settlement proposal and the competing settlement proposals.

In an attempt to rationalize its result, the Commission engaged in a superficial effort to mathematically translate the higher returns on equity allowed to two other gas

[10]Appendix B at A-28.

pipeline companies[11] to the much lower return on equity prescribed for Consolidated. That portion of the Commission's order, which the D.C. Circuit relied upon for its conclusion that the 11.75 percent return was supported by evidence, merely substituted Consolidated's cost of debt (and preferred stock) into the capital structure of another company which had substantially more debt and less equity than did Consolidated. In this way, the Commission and the D.C. Circuit derived a hypothetical return on equity. The Commission concluded:

> If Consolidated's equity ratio was also around 37 percent, the return on equity would be actually 14.48 percent based on the 9.59 percent claimed in Docket No. RP74-90 and 48 percent debt and 5 percent preferred.

Adopting this "translation", the D.C. Circuit apparently assumed that the Commission's "expertise" guaranteed the correctness of the methodology, if not the mathematics.[12] Accordingly, the Court's "test" of the Commission's algebraic approach was equally

[11]Two points are relevant to the Commission's comparison of Consolidated to these other pipelines. Natural Gas Pipeline of American (Opinion No. 762) and Tennessee Gas Pipeline Co. (Opinion No. 769). In neither of these decisions did the Commission stress the equity ratio as a factor, much less as a "major factor". Secondly, the rate of return awarded to Tennessee Gas Pipeline Co. has been remanded to the Commission, Tennessee Gas Pipeline Co. v. FERC, No. 77-1496 (D.C. Cir. June 20, 1979).

[12]Appendix A at A14-15.

erroneous.[13]

The mistake is that both the court and the Commission assumed that the equity ratio would affect both risk and the cost of equity capital, but would not affect the cost of long-term debt and preferred stock. It is axiomatic that a change

[13]A mechanical "translation" of the return on equity cannot support the "comparability" of the return, in the absence of evidence showing the precise correlation between the return on equity and the equity ratio. For example, using Consolidated's cost of debt and preferred stock as determined by the Commission, but assuming that Consolidated had 75 percent debt, 5.00 percent preferred stock, and 20 percent equity, the return on common equity required to yield an overall return of 9.33 percent would be about 20.10 percent. On the other hand, using the same cost of debt and preferred stock but assuming a capital structure of 75 percent equity, 5.000 percent preferred stock and 20 percent debt, a return on equity of only 10 percent would be requried to yield an overall return of 9.33 percent. The mathematics are demonstrated in the following chart:

	Ratio	Cost	Return Components
Long-Term Debt	75.00	6.35	4.76
Preferred Stock	5.00	10.96	.55
Common Equity	20.00	20.10	4.02
Total	100.00		9.33

	Ratio	Cost	Return Components
Long-Term Debt	20.00	6.35	1.27
Preferred Stock	5.00	10.96	.55
Common Equity	75.00	10.01	7.51
Total	100.00		9.33

in the equity ratio necessarily affects *all* components of a company's capitalization.[14]

The comparable earnings test of *Hope* and *Bluefield* is not satisfied by the simplistic "translation" adopted by the Commission and condoned by the court. Absent this "translation" there is no evidence whatever for the Commission's result and the D.C. Circuit's affirmance.

In an era of substantially increased capital costs and strong competition for new sources of capital, the continued application of the *Hope* and *Bluefield* standards is of crucial importance to regulated companies. Capital cannot be conscripted. It must be attracted. The inexorable results of rate of return determinations that do not meet the comparable earnings and capital attractions tests will be a deprivation of capital to regulated companies with a consequent deterioration in the services provided by the regulated sector.

3. The D.C. Circuit's Opinion Disregards The Fundamental Requirement Established in *SEC v. Chenery Corp.*, That Agencies State The Reasons For Their Decisions.

The D.C. Circuit condoned Commission practices which frustrate the fundamental requirement of reasoned decision-making. A basic error of the Commission's order, and the court opinion affirming it, is the total

[14]Even if one assumed, *arguendo*, that the rate of return could somehow be translated from one company to another, there is still a dispute as to whether the comparability test can be properly met if comparisons are made only to other regulated companies, *see e.g.*, Leventhal, *Vitality of the Comparable Earnings Standard for Regulation of Utilities in a Growth Economy*, 74 Yale L. J. 989 (1965).

failure to apply the well-established legal standards for determining the rate or return. That error resulted, in large part, because of the Commission's procedural irregularities which the court condemned, but nonetheless permitted.

It is undisputed that the Commission compared Consolidated's settlement proposal with those made by staff and an intervenor. The Commission conceded as much when it stated in its brief to the D.C. Circuit that it did not consider the positions of the parties at the hearing but, instead, considered only the parties' positions for settlement purposes when it reached its decision.[15]

The D.C. Circuit recognized as much when it held that Consolidated had properly raised the issue of prejudicial use of the settlement proposal in its request for rehearing, an obvious indication that both of the Commissions's orders were tainted. In selecting a rate of return by reference to settlement proposals, and not the hearing record, the Commission violated not only the *Hope-Bluefield* standards, but also its own procedural regulations, which make unaccepted settlement offers privileged.[16] These procedural irregularities were not incidental to an otherwise valid determination of a rate of return.

The lack of reasoned decision-making is obvious from the Commission's July 5, 1977, order. At one point it stated that a rate of return of 11.75 percent on common equity was awarded in the two dockets at issue here[17] and at a later point, stated that the rate of return

[15]Commission Brief to D.C. Cir. at 43, 44.

[16]*See*, Appendix C at A-74.

[17]*See*, Appendix B at A-38, 39.

allowed in those dockets was 12.00 percent.[18] The rate of return cannot be both 11.75 percent and 12.00 percent simultaneously. Consolidated pointed out this inconsistency in its petition for rehearing. The Commission's response was to have its Secretary issue an "Errata Notice".

The Commission is required by this Court's decisions to set forth its evaluation of the record and how it arrives at a conclusion. The Commission's orders in this proceeding and the D.C. Circuit's affirmance thereof, make a mockery of this Court's decision in *SEC v. Chenery Corp.*, 332 U.S. 194 (1947).

[18]*See*, Appendix B at A-46.

CONCLUSION

For the foregoing reasons, Consolidated Gas Supply Corporation respectfully requests this Court to issue a writ of certiorari to review the judgment and opinion of the United States Court of Appeals for the District of Columbia Circuit.

Respectfully submitted,

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November 20, 1979

APPENDICES

APPENDIX A

Orders Of The United States Court Of Appeals For The District Of Columbia Circuit

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Consolidated Gas Supply Corp. v. FERC, No 77-1893 (D.C. Cir., filed July 10, 1979) A-1

Order Denying Rehearing A-17

Order Denying Suggestion For Rehearing *En banc* A-18

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-1893

CONSOLIDATED GAS SUPPLY CORPORATION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, INTERVENOR

Petition for Review of an Order of the Federal Energy Regulatory Commission

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Argued March 23, 1979

Decided July 10, 1979

John E. Holtzinger, Jr. with whom *Karol Lyn Newman* was on the brief, for petitioner.

J. Paul Douglas, Attorney, Federal Energy Regulatory Commission, with whom *Howard E. Shapiro*, Solicitor,

Federal Energy Regulatory Commission, was on the brief, for respondent.

Richard A. Solomon with whom *Peter H. Schiff*, General Counsel, Public Service Commission of the State of New York was on the brief, for intervenor.

Also *Philip R. Telleen* and *McNeill Watkins, II*, Attorneys, Federal Energy Regulatory Commission entered appearances, for respondent.

Also *Sheila S. Hollis* entered an appearance for intervenor.

Before MACKINNON, SWYGERT,[1] and ROBB, *Circuit Judges.*

Opinion for the Court filed by *Circuit Judge* SWYGERT.

SWYGERT, Circuit Judge. This petition for review raises not only a substantial evidence question concerning a public utility's rates of return on common equity, but also a number of administrative procedural problems.

Petitioner Consolidated Gas Supply Corporation (Consolidated) seeks review of a July 5, 1977 order of the Federal Energy Regulatory Commission (the Commission) prescribing rates of return on common equity in connection with Consolidated's rate increase requests originally filed on May 15, 1973 (Commission Docket No. RP 73-107) and May 16, 1974 (No. RP 74-90).[2]

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[1] Of the Seventh Circuit, sitting by designation pursuant to 28 U.S.C. § 291(a) (1970).

[2] The Commission's July 5, 1977 order also prescribed a rate of return for a rate increase proposal filed by Consolidated on April 16, 1975 (No. RP 75-91). In the August 29, 1977 order, however, the Commission granted Consolidated's request for a rehearing in No. RP 75-91, remanding that case for further proceedings on the rate of return issue. It also stayed refunds ordered in that case pending a final decision on the rate of return question. These matters are thus not before us on this petition for review.

Consolidated also appeals from that part of the Commission's order of August 29, 1977 denying rehearing.

The critical issue in this case is whether the rates of return prescribed in the Commission's July 5, 1977 order are supported by substantial evidence. Before reaching that question, we are required to dispose of some preliminary matters regarding the propriety of this appeal and the alleged misuse of a settlement proposal by the Commission.

I

On May 15, 1973 Consolidated filed with the Commission proposed tariff sheets which reflected increased rates and charges. The proposal included a 9.5% overall rate of return and a 12.10% return on common equity. The Commission accepted the filing but suspended the effective date of the proposed rates until December 1, 1973. These rates were then in effect from that date until December 1, 1974.

On May 16, 1974 Consolidated filed proposed tariff sheets for additional increases. This proposal contained a 9.75% overall rate of return and a 12.31% return on common equity. The Commission accepted the filing, suspending the effective date until December 1, 1974. These rates were in effect from that date until November 1, 1975. Other rate filings have since become effective, superceding those at issue here. We are thus concerned with Consolidated's rates of return for the twenty-three month period ending November 1, 1975.

The proceedings in the instant action effectively began with a Commission order consolidating the 1973 and 1974 filings for purposes of hearing and decision. While this matter was pending before an Administrative Law Judge, an assistant general counsel of the Commission sent Consolidated a letter on May 3, 1976. The letter stated that the Commission had determined it would be in the public interest to resolve the matter by settlement.

Pursuant to section 1.18 of the Commission's Rules of Practice and Procedure, 18 C.F.R. § 1.18, Consolidated was therefore asked to submit a settlement proposal. This Consolidated did on June 4, 1976.

An agreement was reached on all cost of service issues except rate of return. That settlement agreement, along with Consolidated's proposal on the rate of return issue, was admitted into evidence by the Administrative Law Judge on August 6, 1976 and certified by him to the Commission on August 9. Consolidated's rate settlement proposal suggested an overall return of 9.46% for the period covered by the 1973 filing, which would yield a 12% rate of return on common equity. For the period covered by the 1974 filing, Consolidated proposed a 9.59% overall return, which included a common equity rate of return of 12.25%.

The parties[3] filed with the Commission initial comments on the settlement agreement and on Consolidated's settlement proposal, and both Consolidated and the Commission's Staff filed reply comments as well. The Public Service Commission of the State of New York (New York) supported Consolidated's proposal for the 1973 filing but recommended that those rates be maintained for the 1974 filing as well. The Commission's Staff recommended a rate of return on common equity of 11.63% and an overall return of 9.27% for both filings.

On July 5, 1977 the Commission issued an order approving the uncontested portion of the settlement agree-

[3] The "parties" involved in the proceeding included Consolidated, the Public Service Company of the State of New York, the New York State Electric and Gas Corporation, the Rochester Gas and Electric Corporation, and the Staff of the Commission. Of these, only Consolidated, the Public Service Commission of the State of New York, and the Commission's Staff are involved in the rate of return issue which forms the basis for this appeal.

ment and "establish[ing] a fair rate of return" on the contested rate issue. The rates of return set by the Commission were 11.75% on common equity and 9.33% overall, which were above those recommended by its Staff but below those proposed by Consolidated and New York.

Consolidated applied for rehearing and reconsideration of the Commission's order on August 1. It pointed out what it thought were inconsistencies in the July 5 order and argued that the prescribed rates of return were not based on substantial evidence. It also asked the Commission to "complete the decisional process" if the Commission chose to deny the rehearing application.

The Commission responded to this request in two ways. First, on August 8, it issued an "Errata Notice" which deleted an incorrect reference in the July 5 order that had created an apparent inconsistency.[4] Then, on August 29, the Commission issued an order denying that part of Consolidated's application for rehearing and reconsideration relevant to this petition for review. Consolidated petitioned this court to review both the July 5 and August 29 orders.

II

The first issue with which we must concern ourselves involves a question of finality. The Commission takes the position that its July 5 order was not a final order, but merely a counteroffer or counterproposal to that tendered by Consolidated. Support for this contention is found in

[4] Although the July 5 order prescribed a rate of return on common equity of 11.75% for the 1973 and 1974 filings, at a later point in that order the Commission had parenthetically categorized a 12% rate as having been allowed for those filings. The errata notice deleted this parenthetical reference.

the title of the order[5] and in some of its language.[6] The Commission argues that because the July 5 order is a mere conditional acceptance of Consolidated's proposal, it is something that Consolidated can "walk away from" if it is unwilling to agree to the conditions of acceptance, namely, the rates prescribed by the Commission. In fact, it is claimed that the Commission has not yet prescribed rates and that they could not be considered "prescribed" until Consolidated filed a motion to withdraw its settlement proposal and the Commission denied the motion.

We need not explore the vagaries of the Commission's position on this issue for we are not convinced by this *post factum* argument. It is manifest from both the order's language and the Commission's analysis of the issues that the July 5 order was intended to be and in fact was final. At the outset of its July 5 order, the Commission stated that it "will approve the settlement agreement and establish a fair rate of return in this order. . . ." Order of July 5, 1977 at 1. At the conclusion, the Commission found that Consolidated "should be required to file tariff sheets reflecting just and reasonable rates as necessary to conform to this order" and then ordered Consolidated to file revised tariff sheets within sixty days "in conformance with the terms of the settlement agreement approved herein and reflecting the conditions described in the body of this order." *Id.* at 23. The language used is that of command and not that of counterproposal.

Beyond this, the Commission's order was not merely a response to a settlement proposal. As we hold *infra*, it

[5] "Order Approving Settlement Agreement Subject to Conditions And Prescribing Reasonable Rate of Return."

[6] *E.g.*: "The Stipulation and Agreement certified to this Commission in this proceeding is hereby accepted subject to the conditions as hereinabove described." Order of July 5, 1977 at 23.

was a decision on the merits based on a record which Consolidated acknowledged to be complete. Inasmuch as the order is "of a definitive character dealing with the merits of a proceeding before the Commission and resulting from a hearing upon evidence and supported by findings appropriate to the case," *Federal Power Commission* v. *Metropolitan Edison Co.*, 304 U.S. 375, 384 (1938), we find the requisite degree of finality to be present for purposes of judicial review.

III

Apart from the question of finality, the Commission raises another objection to our review. As we discuss *infra*, one of Consolidated's objections to the Commission's orders centers on the allegedly improper use by the Commission of Consolidated's settlement proposal in violation of 18 C.F.R. § 1.18(e).[7] The Commission argues that Consolidated is barred from invoking our jurisdiction to review this procedural objection because this objection was not properly raised in the application for rehearing.

Section 19(a) of the Natural Gas Act, 15 U.S.C. § 717r(a), provides that an "application for rehearing shall set forth specifically the ground or grounds upon which such application is based." Section 19(b), 15 U.S.C. § 717r(b), provides that "[n]o objection to the order of the Commission shall be considered by the court

[7] 18 C.F.R. § 1.18(e):

Offers of settlement. Nothing contained in this section shall be construed as precluding any party to a proceeding from submitting at any time offers of settlement or proposals of adjustment to all parties and to the Commission . . . or from requesting conferences for such purpose. Unaccepted proposals of settlement or of adjustment or as to procedure to be followed and proposed stipulations not agreed to shall be privileged and shall not be admissible in evidence against any counsel or person claiming such privilege.

unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do."

Consolidated argues that its objection to use of the settlement proposal was properly raised. The May 3, 1976 letter from the Commission's assistant general counsel indicated that a settlement proposal was being requested "pursuant to . . . Section 1.18." Consolidated's proposal and its motion for adoption thereof both referred to section 1.18. The application for a rehearing of the Commission's July 5, 1977 order characterized Consolidated's offer as an "unaccepted settlement proposal" and stated that Consolidated had not waived its right to a hearing and decision, specifically referring the Commission to 18 C.F.R. § 1.18(e). Moreover, Consolidated argues, the Commission's use of the proposal as evidence against Consolidated did not become apparent until the order denying rehearing; therefore, there were reasonable grounds for failing specifically to urge the objection, if in fact the prior references are found inadequate. And there was no requirement of seeking a rehearing of the rehearing application. *Public Service Commission* v. *FPC*, 543 F.2d 757 (D.C. Cir. 1974).

Although a more specific reference was possible as is evidenced by Consolidated's treatment of the issue before this court, we believe that the Commission had sufficient notice that Consolidated objected to its procedural handling of the matter. The Commission concedes that the application for rehearing "made . . . references to the alleged procedural deficiencies" but styles these as "ambiguous." Brief for Respondent at 34. The specific citation to section 1.18(e), however, together with Consolidated's requests for a hearing and decision on the merits, sufficiently indicate that Consolidated objected to the July 5 order in part because it viewed the order as based on its settlement proposal rather than on the record in

the case. We therefore do not regard as improper our treatment of this procedural objection on its merits.

IV

Considering, then, the merits of Consolidated's procedural objection, there is no evidence in the July 5 order from which we could conclude that the Commission relied on the settlement proposal as evidence against Consolidated in reaching its rate of return decisions. In oral argument before this court, Consolidated conceded that any references to the settlement proposal in the July 5 order were in "basically descriptive language." Nothing in section 1.18(e) prevents descriptive reference to a settlement proposal as opposed to use of that proposal as evidence against the proposer.

If the Commission's decision were not otherwise supportable by substantial evidence on the record, and especially if this were not evident from a reading of the order itself, references to the proposal might fairly lead to the assumption that it was indeed used as evidence, there being nothing else to support the decision. As is discussed *infra*, however, that is not the case here. Consolidated's argument that the decision is explainable only if viewed as a compromise necessarily achieved through use of the competing proposals thus fails because we find its underlying premise to be false.

Of more serious concern is Consolidated's contention that the Commission's denial of its rehearing application must be vacated because of improper use of the settlement proposal. Consolidated points specifically to page six of the August 29 order (footnotes omitted):

> Consolidated next argues that the Commission failed to consider record evidence concerning the company's studies on dividend yield plus the rate of earnings growth. The Commission in its order noted all three studies, which the company's witness testified were not conclusive. The Commission correctly stated that Consolidated did not place much credence in its statistics, since its proposed rates of return were unrelated to the results of its studies:

	Consolidated's Proposed Return on Equity (Settlement Agreement)	Return on Equity Recommended In DCF Statistical Analysis
Docket No. RP73-107	12.00%	14.6% (Tr. 73.)
Docket No. RP74-90	12.25%	14.9% (Tr. 95.)
Docket No. RP75-91	13.58%	14.9% (Exhibit No. 30, Testimony of N.K. Davis at 12-15.)

> The Commission did consider Consolidated's studies in making its decision. However, both the Commission and Consolidated determined that returns on equity substantially lower than those recommended in the studies were justifiable.

It cannot be gainsaid that the Commission in this passage has used the settlement proposals as evidence against Consolidated's position. Neither can it be denied that this use violates the strictures of section 1.18(e). As such it must be condemned. But inasmuch as we hold, *infra*, that the July 5 order was itself based on permissible, substantial evidence, the question remains what effect this use of impermissible evidence in the denial of a rehearing application should have on our review of the Commission's rate determination here at issue.

Generally, when courts have invalidated adjudicatory actions by federal agencies which violated their own regulations promulgated to give a party a procedural safeguard, the basis for such reversals has not been due process but rather a rule of administrative law. *Bates*

v. *Sponberg*, 547 F.2d 325, 330 (6th Cir. 1976). The Administrative Procedure Act, however, provides that a reviewing court shall take due account of the rule of prejudicial error. 5 U.S.C. § 706. We are to take note of this rule, and apply it, even if our review of the agency's action is expressly provided for by another enactment. 5 U.S.C. § 701(a).[8] *Braniff Airways, Inc.* v. *CAB*, 379 F.2d 453, 465 (D.C. Cir. 1967). *See Kerner* v. *Celebrezze*, 340 F.2d 736, 740 (2d Cir.), *cert. denied*, 382 U.S. 861 (1965).

This rule means that "[a] court will not reject an agency finding that is supported by substantial evidence merely because the agency also incidentally mentions incompetent or irrelevant material." *Braniff Airways*, *supra*, 379 F.2d at 466. The appropriate standard is to remand for correction of an error only when there is substantial doubt that the administrative agency would have reached the result it did absent reference to the material. *Id.*; *Denton* v. *Secretary of the Air Force*, 483 F.2d 21, 28 (9th Cir. 1973), *cert. denied*, 414 U.S. 1146 (1974); *Kovac* v. *INS*, 407 F.2d 102, 108 (9th Cir. 1969). *Cf. Arnold* v. *Morton*, 529 F.2d 1101, 1105 (9th Cir. 1976) (if grounds for decision are incorrect, must remand in absence of subjective certainty by court with respect to outcome of agency decision on remand).

We are convinced that Consolidated was not prejudiced by the Commission's unfortunate use of the settlement proposal as evidence in the order denying rehearing. The use occurred in the context of the Commission's discussion of a subsidiary issue: the weight to be accorded

[8] 5 U.S.C. § 701(a) provides:

> This chapter applies, according to the provisions thereof, except to the extent that—
>
> (1) statutes preclude judicial review; or
>
> (2) agency action is committed to agency discretion by law.

certain studies in the record before the Commission. In the July 5 order, the Commission referred to the fact that Consolidated did not regard the studies as conclusive, and that therefore it did not place much weight on them. Order of July 5, 1977 at 13. The record discloses, and Consolidated concedes in its brief,[9] that Consolidated's own witness testified that the studies were not conclusive, although they had some value. Moreover, in the August 29 order denying rehearing, the Commission merely referred to the proposed rates as additional proof that not much weight should be placed on the studies.[10] Inasmuch as an independent basis existed in the record for this subsidiary conclusion of the Commission, and inasmuch as the improper supporting evidence was only cited as additional proof in a denial of rehearing, we are convinced that the same result would have obtained absent the improper reference. Accordingly, we regard the error as nonprejudicial.

V

Finally, then, we reach Consolidated's charge that the Commission's orders must be reversed because they are not supported by substantial evidence. We note first that it cannot be seriously contested that it was improper for the Commission to reject the contested settlement proposal and yet reach a decision on the issue. That question was decided in *Mobil Oil Co.* v. *FPC*, 417 U.S. 283, 313-14 (1974):

[9] Reply Brief for Petitioner at 17.

[10] The proposed rates filed by Consolidated in 1973 and 1974 were very close to those in its settlement offer. In No. RP 73-107, the filed rate of return on common equity was 12.10%, and the settlement offer was 12.00%. Similarly, in No. RP 74-90, the filed rate was 12.31% on common equity, and the settlement offer was 12.25%. Thus, like the settlement offers, Consolidated's filed rates differed greatly from the rates indicated by the studies, which difference tends to undercut the reliability of those studies.

We think that the Court of Appeals correctly analyzed the situation and stated the correct legal principles:

> "No one seriously doubts the power—indeed, the duty—of FPC to consider the terms of a proposed settlement which fails to receive unanimous support as a decision on the merits. We agree with the D. C. Circuit that even 'assuming that under the Commission's rules [a party's] rejection of the settlement rendered the proposal ineffective *as a settlement*, it could not, and we believe should not, have precluded the Commission from considering the proposal *on its merits*.' Michigan Consolidated Gas Co. v. FPC, 1960, 108 U.S. App. D.C. 409, 283 F.2d 204, 224 . . . ." 483 F.2d at 893.

As we stated in *Pennsylvania Gas & Water Co.* v. *FPC*, 463 F.2d 1242 (D.C. Cir. 1972), a settlement proposal in a proceeding like the instant one is in the nature of a motion for summary judgment, and the agency may reach such a judgment on such terms as it deems fair from the evidence before it. *Id.* at 1246. The standard for judicial review of an administrative order arising out of the submission of a contested settlement proposal is whether the order amounts to a resolution of the issue on the merits, that is, whether the Commission has made an independent rate determination supported by substantial evidence on the record as a whole. *Mobil Oil*, *supra*, 417 U.S. at 314. It is to an evaluation of the Commission's orders under that standard that we now turn.

Consolidated challenges that part of the Commission's order of July 5 which prescribes a rate of return on common equity of 11.75% with an overall return of 9.33%. Seven full pages of the July 5 order deal specifically with this issue, Order of July 5, 1977 at 8-14, as do seven pages of the August 29 order denying rehearing, Order of August 29, 1977 at 2-8. The Commission noted

five criteria which Consolidated had considered in establishing its proposed rates of return: current market conditions, the yield and growth rate available to investors, earnings on book value, market to book ratio, and future capital needs. The Commission then discussed the record evidence in detail, often contrasting Consolidated's testimony and calculations with those offered by the Commission's staff. This discussion is replete with specific citations to the record.

The principal complaint of Consolidated is that the rates of return allowed by the July 5 order are arbitrary and do not follow from the record evidence discussed by the Commission when viewed in light of the Commission's actions in other recent proceedings. While it is evident that the rates allowed Consolidated are not directly comparable to those allowed in other proceedings, the Commission's own reasoning in the July 5 order shows why this is so:

> Consolidated argues that its proposed returns on common equity are in line with recent Commission precedent. The company compared its proposed return on common equity of 12.0% in Docket No. RP73-107 to that of the 13.69% allowed to Tennessee Gas Pipeline Company in Docket No. RP73-113 [Opinion No. 769, issued July 9, 1976]. Consolidated also compared its request for a 12.25% return on common equity in Docket No. RP74-90 with the 13.50% allowance on common equity allotted to Natural Gas Pipeline Company of America in Docket No. RP74-76 [Opinion No. 762, issued May 21, 1976]. As pointed out by PSNY, however, the ratio of common equity in all three Consolidated dockets at issue here stands—in excess of 50%. A key factor in supporting the equity return levels in the *Natural* and *Tennessee* cases, however, was the lower equity ratios for those companies. Natural's equity ratio was 36.38% in Docket No. RP74-96, and Tennessee's equity ratio in Docket No. RP73-113 was 37.09%.

> If Consolidated's equity ratio were also around 37%, the return on equity would be actually 14.48% based on the 9.59% claimed in Docket No. RP74-90, and using 58% debt and 5% preferred and the costs as indicated in Consolidated's capital structure on page 7, *supra*.

Order of July 5, 1977 at 13. Consolidated concedes, moreover, that it has more equity in its capital structure than some of the other companies and that this is a factor in risk. The Commission gave greater weight to this factor than Consolidated thought was appropriate, but it is apparent that through this factor the rates of return allowed to Consolidated may be "translated" into rates comparable to those allowed in the other cases.[11] Thus the rates allowed are reasonably in line with Commission precedent, and we agree with the Commission that they are fully supported by substantial record evidence.

Consolidated contends that because the Commission's reasoning process is not explicated in detail in the July 5 and August 29 orders, these orders do not amount to reasoned decisionmaking and cannot survive judicial review. "But the path which it followed can be discerned." *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 595 (1945). *See also Bowman Transportation, Inc.* v. *Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 286 (1974) ("[W]e will uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.")

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[11] By the same reasoning as the Commission employed, the 9.33% overall return granted by the Commission equates, on a 58% debt, 5% preferred, 37% equity ratio (with debt and equity costs as in fact incurred by Consolidated), to a return on equity of 13.78%, higher than that allowed either for *Natural* in Opinion No. 762 (13.5%) or *Tennessee* in Opinion No. 769 (13.75%. The Commission's reference in the above quote from its July 5 order to a 13.69% rates appears to be in error).

It is apparent that, following its detailed comparison of the evidence presented by both Consolidated and the Commission's staff, the Commission concluded that the relatively low financial risk enjoyed by Consolidated because of its high equity ratio was to be a major factor in the rate decision. This was in keeping with its recent precedent, for the Commission noted that a "key factor" in the *Natural* and *Tennessee* cases had been the lower equity ratios of those companies. Order of July 5, 1977 at 13. Applying its expertise, the Commission then chose a rate which, allowing for the difference in equity ratios, placed Consolidated "within the zone of reasonableness" determined by its precedent for the relevant period. "[T]he Commission is not required by the Constitution or the Natural Gas Act to adopt as just and reasonable any particular rate level; rather, courts are without authority to set aside any rate selected by the Commission which is within a 'zone of reasonableness.'" *Mobil Oil, supra*, 417 U.S. at 307, *quoting* from *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968).

We conclude, then, that the Commission's path to decision was sufficiently clear to permit our review. That review has revealed the Commission's decision to have been an independent one supported by substantial evidence from the record as a whole. Accordingly, the petitions for review of the Commission's July 5, 1977 and August 29, 1977 orders are dismissed and the orders are to be enforced.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 77-1893

September Term, 1978

Consolidated Gas Supply Corporation,
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

BEFORE: Swygert*, Circuit Judge, United States Court of Appeals for the Seventh Circuit; MacKinnon and Robb, Circuit Judges

O R D E R

Upon consideration of petitioner's (Consolidated Gas Supply Corporation) petition for rehearing, it is

ORDERED, by the Court, that petitioner's aforesaid petition for rehearing is denied.

Per Curiam

FOR THE COURT:

GEORGE A. FISHER
Clerk

*Sitting by designation pursuant to Title 28 U.S.C. § 291(a).

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

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September Term, 1978

Consolidated Gas Supply Corporation,
Petitioner

v.

Federal Energy Regulatory Commission,
Respondent

BEFORE: McGowan, Leventhal, Robinson, MacKinnon, Robb, and Wilkey; Circuit Judges

O R D E R

The suggestion for rehearing en banc filed by petitioner Consolidated Gas Supply Corporation, having been transmitted to the full Court and no judge in regular active service having requested a vote with respect thereto, it is

ORDERED, by the Court, en banc, that petitioner's aforesaid suggestion for rehearing en banc is denied.

Per Curiam

FOR THE COURT:

GEORGE A. FISHER
Clerk

APPENDIX B

Orders Of The Federal Energy Regulatory Commission

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Order Approving Settlement Agreement Subject To Conditions and Prescribing Reasonable Rate Of Return A-20

Errata Notice A-51

Order Granting In Part And Denying In Part Application For Rehearing A-53

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Richard L. Denham, Chairman; Don S. Smith, and John H. Holloman III.

Consolidated Gas Supply Corporation) Docket Nos.

RP73-107, RP74-90 and RP 75-91

ORDER APPROVING SETTLEMENT AGREEMENT SUBJECT TO CONDITIONS AND PRESCRIBING REASONABLE RATE OF RETURN

(Issued July 5, 1977)

On August 10, 1976, Administrative Law Judge Stephen L. Grossman certified to the Commission a settlement agreement in resolution of all cost of service issues raised in these consolidated proceedings, with the exception of rate of return, which the parties are contesting in comments to the Commission. Judge Grossman also certified portions of

the record pertinent to the cost of service issues. On December 10, 1976, Judge Grossman rendered his Initial Decision determining the issues cost allocation, cost classification, and rate design issues in these proceedings. The Commission will approve the settlement agreement and establish a fair rate of return in this order and will issue a separate opinion and order in consideration of the cost allocation, classification and rate design issues. Controversies concerning depreciation and pipeline production have been severed from these proceedings and will be considered at a later date.

PROCEDURAL BACKGROUND

On May 15, 1973, Consolidated Gas Supply Corporation (Consolidated) tendered for filing with the Commission proposed tariff sheets reflecting increased rates and charges in Docket No. RP73-107. By order issued on June 29, 1973, the Commission accepted the tariff sheets for filing, suspended the effective date of the proposed rates until December 1, 1973, and granted intervention to several interested parties.

On May 16, 1974, Consolidated filed proposed tariff sheets for additional rate increases in Docket No. RP74-90. The Commission on June 24, 1974, accepted the tariff sheets for filing, suspended their effectiveness until December 1, 1974, and on September 13, 1974,

consolidated Docket No. RP74-90 with Docket No. RP73-107. In the interim the Commission issued Opinion No. 703,[1] determining just and reasonable rates in Consolidated's earlier filing, Docket No. RP71-77. Consolidated thereupon filed in these consolidated proceedings substitute tariff sheets complying with the Commission's decision in Opinion No. 703. The Commission accepted the substitute tariff sheets for filing to become effective on December 1, 1974.

Consolidated filed tariff sheets seeking an additional rate increase in Docket No. RP75-91 on April 16, 1975. On May 19, 1975, the Commission issued an order accepting the proposed tariff sheets and suspending their effectiveness until November 1, 1975. These proceedings were consolidated with the proceedings in Docket Nos. RP73107 consolidated with the proceedings in Docket Nos. RP73-107 and RP74-90 by a Commission order issued on August 25, 1975.

UNCONTESTED SETTLEMENT AGREEMENT

During a joint settlement conference held on August 6, 1976, in Docket No. RP75-91, the presiding Administrative Law Judge admitted into evidence Exhibit No. 36, which is a settlement agreement concerning cost of service issues in Docket Nos. RP73-107, RP74-90 and RP75-91. The company also filed a motion for approval of the agreement. Upon certification of the stipulation and the record to the Commission, Consolidated, Public Service Company of the

[1] *Consolidated Gas Supply Corporation*, Docket No. RP71-77, Opinion No. 703 issued on August 28, 1974.

State of New York (PSNY), New York State Electric and Corporation (RG&E) and Staff initial comments. Both Consolidated and Staff filed reply comments.

The settlement agreement is based upon Staff's adjusted cost of service. Cost of service data was filed in four statements appended to the settlement agreement: Statement A sets forth the Staff's cost of service for the twelve month locked-in period ending November 30, 1974; Statement B shows Staff's cost of service for the twelve month period ended October 31, 1974; Statement C consists of Staff's cost of service for the twelve months ended September 30, 1975. Statement D shows the controverted capitalization ratios, rates of return on common equity, and overall rates of return for the three locked-in periods covered by Docket No. RP73-107, Docket No. RP74-90, and Docket No. RP75-91.

Article I of the stipulation provides that Consolidated will make the appropriate rate reductions and issue refunds only upon the parties' settlement of or the Commission's decision with respect to the issue of cost allocation and rate design. Consolidated also reserved its right to offer additional testimony on the depreciation issue remaining in Docket No. RP75-91.

Under Section 1 of Article II Consolidated may increase or decrease its rates to track changes in rate base caused by net changes in the amount of outstanding advance payments. The changes are to be determined "by multiplying 17.73 percent times the difference between (a) the amount of outstanding advance payments and (b) the

amount $14,658,415 included in the rate base used in determining the cost of service underlying Statement C, or this base amount adjusted to reflect prior changes under this Article. Consolidated agreed to calculate any changes in rates on a volumetric basis. The company is required under this settlement agreement to submit in its tracking filings an affidavit explaining the basis of the change and describing any new agreements proposed to be tracked.

Section 2 of the Article II allows Consolidated to track changes in its cost of service for the cost of gas transported by others. The amount to be tracked shall be calculated as the amount by which annual transportation costs differ from the base amount of $14,524,656 (see Statement C). Changes in rates are to be calculated on a volumetric basis. The agreement also provides that Account No. 191, Unrecovered Purchased Gas Costs, shall be credited with refunds, including interest, applicable to rate schedules used in computing the base amount. The Commission will require those refunds to include interest at an annual rate of 9 percent.

In Article III, the parties reserve their rights to contest matters not provided for in the stipulation.

The Commission hereby accepts and approves the uncontested aspects of the settlement agreement, as they are in compliance with the Commission's rules and regulations.

CONTESTED PORTIONS OF SETTLEMENT AGREEMENT

1. Coal Gasification.

Rochester Gas and Electric Corporation (RG&E) objects to the exclusion from the settlement cost of service of Consolidated's investment in coal reserves for future coal gasification plants. A full requirements customer of Consolidated, RG&E regards these expenses as reasonable and necessary to assure RG&E and other customers that their future demands will be met. RG&E proposed that the following amounts be included in Consolidated's cost of service for coal gasification expenses:

RP73-107	$595,700
RP74-90	$507,300
RP75-91	$875,500

RG&E further objects on the basis that, if these expenses are directly excluded from the cost of service, Consolidated's customers will be forced to bear these expenses indirectly, by providing Consolidated's investors with a higher return on common equity to compensate them for the risks created by dwindling gas supplies. In essence, RG&E's complaint is that "by paying for the coal gasification project indirectly rather than directly, the customers of Consolidated lose the protection of this Commission, . . . /which should/ have jurisdiction over to whom the output of the project is sold and at what rates it is sold."[2]

[2]RG&E comments on Settlement Proposal, at 2-3.

RG&E correctly notes that the Natural Gas Act does not give the Commisison the jurisdiction over gasified coal. RG&E therefore suggests that Consolidated could "contractually give the Commission practical jurisdiction"[3] and claims that Consolidated expressed a willingness to agree to appropriate terms and conditions regarding this matter.[4]

In reply to RG&E's comments, Staff argued that consumers should bear only those costs related to natural gas which they are receiving or have a reasonable expectation of receiving. Because Consolidated's ratepayers are not receiving any gas produced by coal gasification, and because they do not expect to receive any such gas in the near future, Staff reasons that the consumers should not bear costs of coal gasification until it is a reality.

In rebuttal to RG&E's reliance upon the settlement approved in *Texas Gas Transmission Company, supra,* in support of its suggestion that Consolidated "contractually give the Commission practical jurisdiction" over this matter, Staff adequately distinguished the *Texas Gas* settlement from the present case:

> First, the Texas Gas provision on inclusion of coal reserves in rate base was dependent upon the outcome of litigation concerning the propriety of such inclusion. In the context of the instant case, this question comes before the Commission as a

[3]Ibid., citing, *Texas Gas Transmission Corporation,* Docket No. RP76-17, Stipulation and Agreement filed on July 23, 1976.

[4]Tr. 1087.

> settlement proposal which does not offer the full hearing of litigation. Second, the instant proposal contains no language similar to that in the Texas Gas Agreement that Consolidated would agree to place any gas which may result in its jurisdictional flow of gas. (Staff Reply Comments at p. 3).

The Commission pronounced its policy on the inclusion of expenses for coal reserves for gasification in *Michigan Wisconsin Pipe Line Company:*

> our lack of jurisdiciton over coal gasification facilities does not, standing alone, prevent this Commission from approving expenditure to such projects if the Commisison believes such expenditures will yield substantial benefits to the consumer within a reasonable period of time.[5]

There is no evidence on the record demonstrating that the expenses for coal reserves will yield benefits for RG&E or other customers. There is no certainty that Consolidated will ever actually mine the coal or gasify it. The Commission finds that, in the interests of the consumers, expenses for the company's coal reserves should not be included in Consolidated's cost of service.

[5]51 FPC 2408, 210 (1974); See also *Michigan Wisconsin Pipe Line Company,* 52 FPC 928(1974); *Southern Natural Gas Company,* Docket No. RP74-93, Order Denying Petition for Declaratory Order, issued on September 4, 1974, and Order Denying Applications for Rehearing and Reconsideration, issued on October 30, 1974.

2. Savings on Reacquired Debt in Long Term Debt.

None of the parties dispute the capital structure in Docket Nos. RP73-107 and RP74-90, as of December 31, 1974, as adjusted:

	Amount	Ratio	Cost	Return Components
Long Term Debt	$575,384,000	44.22%	6.35%	2.81%
Preferred Stock	500,000,000	3.84	10.96	.42
Common Equity	675,694,000	51.94		
Total	$1,304,078,000	100.00%		

Consolidated's settlement proposal indicates the settlement cost of long term debt to be 6.35%, which include savings from reacquired debt. Nonetheless, Consolidated attached to its initial comments on the settlement agreement excerpts from its initial brief in these proceedings, in which Consolidated argued that these savings should excluded from long term debt. Staff voiced its understanding that the parties agreed to a 6.35% cost of long term debt. In rebuttal to Consolidated's position, Staff appended to its comments excerpts from its briefs filed in these proceedings on the subject.

In keeping with the Commission's policy on reacquired debt as set forth in Opinion No. 583,[6] the Commission finds that all discounts and savings associated with the reacquisition of debt should be amortized over the remaining life of the old debt, and the amortized amount then be included as a credit to the embedded cost of debt. This policy insures that the consumer who pays the carrying charges for long term debt will benefit from the savings realized from reacquisition. We find that a 6.35% cost of long term debt in Docket No. RP73-107 and Docket No. RP74-90 is equitable.

3. Rate of Return.

Consolidated, the Public Service Commission of the State of New York (PSNY), and the Commission Staff contest the level of return on common equity and overall rate of return in Docket No. RP73-107, Docket No. RP74-90, and Docket No. RP75-91. Consolidated proposes a 12.0% rate of return on common equity, with a 9.46% overall return, for the period covered by Docket No. RP73-107, and proposes a 12.25% return on common equity and a 9.59% overall return in Docket No. RP74-90. PSNY supports Consolidated's proposal in Docket No. RP73-107, but recommends these same levels of return be maintained in Docket No. RP74-90. Staff advocates a return on common equity of 11.63%, with an overall return

[6] *Manufacturers Light and Heat Company, et al.*, 44 FPC 314 (1970). See also, *Consolidated Gas Supply Company*, Docket No. 71-77, Opinion No. 703 issued on August 28, 1974, at 12-13; *Kansas-Nebraska Natural Gas Company*, Docket No. RP72-32, Opinion No. 731 issued on May 15, 1975, at 24.25.

of 9.27% in both Docket No. RP73-107 and Docket No. RP74-90. In Docket No. RP75-91, Consolidated requests an overall return of 10.50% with a 13.58% return on common equity. PSNY recommends an overall return ranging from 9.81% to 9.83% with a return on common equity between 12.25% and 12.30%. Staff recommends an overall return ranging from 9.48% to 9.67%, with a return on common equity of 11.63% to 12.00%.

Consolidated is a wholly-owned subsidiary of the Consolidated Natural Gas Company (Consolidated Natural). All of its financing is obtained through the parent company. All parties agree that as a result of this relationship the proper capital structure to use for determining the overall rate of return is that of Consolidated Natural. It is further agreed that the cost of money to Consolidated Natural is representative of the cost of money to Consolidated. Accordingly, the costs of debt and preferred stock are that of the consolidated parent and analysis of return on common equity is based on financial and market indicators of Consolidated Natural.[7]

(a) Docket No. RP73-107 and Docket No. RP74-90.

Consolidated considered five criteria in establishing its proposed rates of return for the locked-in periods covered by Docket No. RP73-107 and Docket No. RP74-90: current market conditions, the yield and growth rate available to its investors, the company's earnings on book value as compared with other investment opportunities, its market to book ratio, and Consolidated's future needs for additional capital.[8]

[7]Tr. 55, 196.

[8]Tr. 62 and 92

Consolidated testified that the increasing shortage of gas supplies has made it necessary for gas supply corporations to invest in programs designed to develop additional sources of natural gas. [9] Consolidated Natural has invested considerable sums of capital in these programs, and testified that its capital expenditures for the five year period from 1973 to 1977 would amount to $920,000,000, or about $184,000,000 annually. [10]

The Commission Staff noted that between 1969 and 1973 the utility industry has made greater demands for capital under less than favorable conditions, and agrees that over the period from 1973 to 1978 the industry would far exceed those high demands.[11] The Staff confirmed Consolidated's testimony as to the decreasing reserve to production ratio caused by severe curtailments of natural gas for the pipeline industry as a whole.[12] Staff did however place Consolidated into proper perspective operationally:

> Consolidated Gas Supply is the Consolidated Natural Gas Company's interstate transporter and seller of gas to Consolidated's distribution subsidiaries, located primarily in the states of Pennsylvania, Ohio, West Virginia, and New York. As of 1973, the system acquired natural gas through its own production in Louisiana and Appalachia (12%), from the Southwest through

[9]Tr. 82; See also, Tennessee Gas Pipeline Company, Docket No. RP73-113, Opinion No. 769 issued on July 9, 1976, at 11.

[10]Tr. 83-84, 98, 123-125, and 141-142.

[11]Tr.94.

[12]Tr. 95. Consolidated's curtailments in 1973 amounted on only 1.5% of the total curtailment.

purchases from five interstate pipeline companies (75%), and from Appalachian area producers (13%).

Consolidated's gas supply posture would appear to be somewhat better than the interstate transmission industry, as a whole. According to 1974 data filed with the FPC, Consolidated's Reserve/Life Index stood at 17.2, and its Reserve/Production Ration was about 19.1. Curtailments by Consolidated during the first quarter of calendar year 1975 amounted to 10,192,000 Mcf, or approximately 1.5% of industry-wide curtailments represented by some 22 pipeline companies. Based on Form 16 filing, Consolidated projects a deficiency of 43,756,000 Mcf, or 5.6% firm requirements which is well below total industry projected deficiency of 15.8% for the period, September 1974-August 1975. Moreover, Consolidated could well improve its supply posture through supplemental gas projects such as SNG and imported LNG, as well as additional reserves from Canada and the Texas Louisiana coastal area.

On the other hand, the four interstate pipeline companies that supply Consolidated Gas Supply with the vast majority of its gas are faced with curtailments that eventually could place Consolidated in a relatively vulnerable position. For example; the four companies - Texas Eastern, Tennessee Gas, Transcontinental, and Texas Gas - had curtailments during the first quarter of 1975

of 148,657,000 Mcf, or over 22% of the total curtailments of the 22 major pipeline companies.[13]

Consolidated's Exhibits Nos. 18 and 22 provide an overview of the rapid growth of the economy and the rate of inflation experienced by this nation historically. Consolidated emphasized the prevailing high interest levels and the general increase on cost of debt capital for utilities at the time these filings were made.[14] The Commission Staff agreed that inflation has had a tremendous effect upon the cost of capital goods, which added pressure to the capital markets. Staff stated that the high interest rates during the period 1969 through most of 1974 were principally a function of increasing inflationary expectations by investors" and that the "inflationary rate has been reduced substantially from the 12% yearly rate of 1974 to around 7%." Staff also cited projections of further declines. Referring to Opinion No. 703 which emphasized trends in interest rates, Staff stated that "the trend...during the period 1965-1971, or even through the time Opinion 703 was drafted in 1974, should /not/ be considered as irreversible as the Opinion implies." Staff, however, agreed with the permanence and degree of long-term interest rate increases suggested by the Opinion. Staff, however, agreed that the trends in long term interest rate has been upward and that it should and was considered in Staff's recommended rate of return on equity. On cross examination this point was clarified when Staff stated its belief that interest rates would decline during the first half of 1976.[15]

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[13]Tr. 195-196.

[14]Tr. 67-69 and 93; Exhibit No. 18, Tables 11 and 12; Exhibit No. 22, Table

[15]Tr. 192-193, 197-199, 203-205.

Consolidated testified that the company realized "substantially less return on its average common equity than any of /Moody's/ Gas and Electric industry groups."[16] Consolidated attributes the depressed market value of its stock to its low equity returns through 1972.[17] Staff employed the comparable earnings approach to demonstrate what returns would be on the best alternative investments as compared to those of Consolidated. Staff's Exhibit No. 43 also shows that Consolidated has been experiencing lower returns on common equity than other utility groups. Staff however finds this to be largely the result of its substantially higher common equity ratio. The Staff's exhibits show that high business risk industrials use a capital structure containing significantly more common equity and fewer senior debt obligations than regulated utilities. Staff testified that Consolidated's stronger equity ratio was a positive factor, since its after tax coverages have consistently exceeded those of other utility groups. This financial stability has resulted in Consolidated's Aa bond rating by Moody's, whereas most pipeline bonds are much lower. Staff stated that these three indicators reveal that Consolidated's financial risk is relatively lower than that of comparable groups.[18]

While Consolidated agrees that its high bond rating is a result of its high equity ratio, the company argues that its equity ratio, has no direct relationship to the allowance of return on common equity:

[16]Tr. 74 and 95; Exhibit No. 18, Tables 28 and 29; Exhibit No. 22, Table 28.

[17]Tr. 75; Table 31 of Exhibit No. 18 shows that in 1972 Consolidated's stock sold at 9.2% less than its book, as compared to an average market price of 18.7% above book value for Moody's 10 Integrated Natural Gas Companies. Staff noted that Consolidated's market to book ratio had improved by the time its testimony was written (Tr. 199).

[18]Tr. 196-197.

> At best the equity ratio of Consolidated is a modest plus factor in a comparison of risk, but a plus factor which is more than offset by the Company's relatively poor return on equity as shown on Table 29; the tendency of its equity to sell at market prices below book value compared to the premium sales price of comparable companies as shown on Table 22; and the relatively high yield plus growth cost evidenced reflected in a comparison of Table 27 with Tables 15, 17, 19, 21 and 23 / of Exhibit Nos. 18 and 22./ . . . /T/here is on balance no reason why the equity allowance for Consolidated should not be directly comparable with various other gas utility groups. . . There is therefore no basis whatsoever for an arbitrary reduction in the equity allowance based upon a 52% equity ratio. To treat Consolidated's equity on this basis would merely perpetuate its poor earnings record, drive its equity-market value further below the book value and make it impossible for the Company to finance through the sale of equity securities at a reasonable cost and without dilution of the investment of the existing stockholders.[19]

Consolidated's earnings-price ratio has climbed from 8.4 in 1968 to 11.2 in 1972. With an allowance of 10 percent for issuance costs, the average earnings-price ratio for the 12 months ending April, 1973 was 12.04, having fluctuated between 10.98 and 13.30. Consolidated argues that "in no event can the cost of equity capital (and thus the required return on equity) to Consolidated be less than 12% and that it is, in fact, some higher" for Docket No. RP73-107.[20]

[19]Tr. 78-79; Exhibit No. 18, Tables 37 and 38.

[20]Tr. 79-82

Using the same reasoning, Consolidated concluded from Exhibit 22, showing a 13.7% earnings-price ratio for the 12 month period ending March, 1974, that 12.5-13.0% return on equity was necessary in Docket No. RP74-90.[21] Consolidated's settlement proposal requests a return on common equity of 12.0% with an overall return of 9.46% in Docket No. RP73-107 and a return on common equity of 12.25% with an overall return of 9.59% in Docket No. RP74-90.

Staff's Exhibit No. 43 shows that in comparing the price-earnings multiples (P/E) (which is the reciprocal of the earnings-price ratio) of Consolidated and other companies, Consolidated was in a more favorable position than industrials nad utilities. The trend for P/E for most industrials and utilities fluctuated, while that of Consolidated was considerably more stable. While the P/E levels for industrial was fairly stable for four consecutive years, they dropped sharply by about 4.5 in 1973. A slighter decline was experienced by utilities in 1973, with the exception that Consolidated showed a gain which placed it above the P/E of Class A and B pipelines and close to that of Moody's utilities.

In addition to considering comparable earnings of other investment opportunities, Consolidated calculated its proposed return on common equity on the basis of dividend yield plus anticipated growth.[22] Consolidated determined that the "sum of the dividend yield of 6.97% and the rate of earnings growth of 6.21% for the period 1962-1972 together with the 10% cost factor gives an indicated cost of equity capital for Consolidated Natural Gas Company of 14.6%".[23] While Consolidated does not find its dividend yield study

[21]Tr. 97-99.
[22]Tr. 69-74 and 94-95.
[23]Tr. 73

to be conclusive, the company employed its study to prove that the return on equity for Consolidated Natural Gas Company should be in the 12% to 13% range for the period covered by Docket No. RP73-107.[24] For Docket No. RP7490, Consolidated calculated that the "sum of the dividend yield of 8.33% and the rate of earnings growth of 5.10% for the period 1963-1973 together with the 10% cost factor gives an indicated cost of equity capital to Consolidated Natural Gas Company of 14.9%."[25] As Consolidated did not place much credence in these statistics, neither will the Commission.

Consolidated argues that its proposed returns on common equity are in line with recent Commission precedent. The company compared its proposed return on common equity of 12.0% in Docket No. RP73-107 to that of the 13.69%, allowed to Tennessee Gas Pipeline Company in Docket No. RP73-113.[26] Consolidated also compared its request for a 12.25% return on common equity in Docket No. RP74-90 with the 13.50% allowance on common equity allotted to Natural Gas Pipeline Company of America in Docket No. RP74-96.[27] As pointed out by PSNY, however, the ratio of common equity in all three Consolidated dockets at issue here stands - in excess of 50%. A key factor in supporting the equity return levels in the *Natural* and *Tennessee* cases, however, was the lower equity ratios for those companies. Natural's equity ratio was 36.38% in Docket No. RP74-96, and Tennessee's equity ratio in

[24]Tr. 74.
[25]Tr. 95.
[26]Opinion No. 769, issued on July 9, 1976.
[27]Opinion No. 762, issued on May 21, 1976.

Docket No. RP73-113 was 37.09%. If Consolidated's equity ratio were also around 37%, the return on equity would be actually 14.48% based on the 9.59% claimed in Docket No. RP74-90, and using 58% debt and 5% preferred and the costs as indicated in Consolidated's capital structure on page 7, *supra.*

The Commission does not find Consolidated's low return on common equity to be cause for great concern in consideration of the company's high percentage of equity in its capital structures. The Aa rating of is bonds and its high after tax coverages indicate financial strength based upon the company's low proportion of debt. It stands to reason that the lower the degree of leverage, or amount of debt, the smaller the financial risk faced by investors, and the lower the return on common equity required by the company to compete for investor's funds. While we agree with Consolidated that "there is no basis for an arbitrary reduction in the equity allowance based upon a 52% equity ratio," the Commission finds that the equity ratio is a major factor to be considered in these proceedings. Upon review of the record for Docket No. RP73-107, the Commission finds that a return on common equity of 11.75% resulting in an overall rate of return of 9.33% is both just and reasonable, falling within the zone of reasonableness for the period covered by these two dockets. The Commission notes that while this rate is only slightly above that granted in the preceding docket and recommended for both Docket Nos. RP73-107 and RP74-90, by Staff, it is fully supported by the record evidence.

While the record shows that Consolidated fared as poorly as other utilities experiencing declining market-to-

book and price-earnings ratios, the market in general showed some improvement during the locked-in period covered by Docket No. RP74-90:

> While we would not be justified solely using hindsight to evaluate the evidentiary presentations, we cannot ignore the market improvement that occurred after Natural filed its case . . . We also note for illustrative purposes in this context that the Federal Reserve discount rate, which was 8% from April to December 1974, declined to 6 1/4% by March 1975. Similarly, the bank prime rate declined from as high as 12% in July 1974 to 7 1/2% by the end of March 1975.[28]

Staff in fact testified that at the time of hearings in Docket No. RP74-90, long term interest rates has returned to approximately the level existing in 1970, after reading unprecedented highs, during the interim.[29] We therefore find that the rate of return allowed in Docket No. RP73-107 should be maintained in Docket No. RP74-90.

(b) Docket No. RP75-91.

The most recent of the three consolidated proceedings, Docket No. RP75-91, covers a locked-in period extending from November 1, 1975 to April 30, 1977. During a joint settlement conference held on August 6, 1976, the presiding Administrative Law Judge received into evidence testimony and exhibits prepared by Consolidated and the Staff on cost

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[28]Opinion No. 762, at 16-17

[29]Tr. 198.

of service issues, including rate of return, in Docket No. RP75-91. None of the witnesses for the company or the staff were cross-examined on their testimony. The settlement agreement concerning all cost of service issues in the three consolidated dockets was also received in evidence on August 6, 1976.[30]

In proposing a rate of return on common equity and overall rate of return in Docket No. RP75-91, Consolidated used the same five criteria employed in Docket No. RP73-107 and Docket No. RP74-90. Consolidated's Exhibit No. 2 shows the inflationary trends in the nation's economy and higher cost of capital. Consolidated witness N.K. Davis testified that the parent company must now engage in costly and risky projects to ease the burdens created by the shortages of natural gas supplies. He anticipated that for the five year period from 1975 to 1979 Consolidated Natural's capital expenditures would total $970,000,000, or an average of $194,000,000 per annum. In comparing these projected figures with the expenditures for the five year period ending in 1974, which amounted to $611,700,000 or $122,300,000 annually, Mr. Davis concluded that Consolidated's future capital requirements will exceed previously experienced capital needs by about 59%.[31] Consolidated plans to finance part of its capital requirements through the issuance of common stock by Consolidated Natural. However, the Company postponed plans to issue common stock in 1973 and 1974 due to unfavorable market conditions.[32]The company seeks a return on equity of 13.58% in Docket No. RP75-91 to attract aditional capital.

[30]Exhibit No. 36 in Docket No. RP75-91.

[31]Exhibit No. 30, Prepared Testimony of N.K. Davis, at p. 23.

[32]*Ibid.*, at p. 24.

Staff agrees with Consolidated that higher money rates created by inflation and increased operating costs unfortunately came at a time when greater amounts for capital were needed to develop additional natural gas supplies.[33] Staff does point out, however, that the current rate of inflation has been declining substantially: the 12% yearly rate for 1974 dropped to 7% for the last quarter of 1975, and the rate was projected to decline further to 5-6% for 1976 when Staff's testimony was filed.[34] As Staff noted in Docket Nos. RP73-107 and RP74-90, Consolidated's gas supply situation is better than that of the industry as a whole: the company projected a deficiency of 7.15% of its firm requirements, well below the 22% deficiency projected for the total industry for the period September 1975 through August 1976. Staff did however note with concern that Consolidated's four suppliers projected curtailments during the twelve months ending August 1976, which amount to 26% of the total projected curtailments for major pipelines.[35]

The company again voiced its concern as to the substantially lower returns on its average common equity. Consolidated testified that it returns compared unfavorably to the returns of other gas transmission companies and integrated companies in Docket Nos. RP73-107 and RP74-90.[36] The Company's Exhibit No. 2 in Docket No. RP75-91 shows that its return dropped from 10.21% in 1972 to 8.77%

[33]Exhibit No. 31, Prepared Testimony of Jack M. Adelman, at p. 7.

[34]*Ibid.* at p. 13.

[35]*Ibid.* at p. 10-11.

[36]See footnotes 16 and 17, and corresponding text.

in 1973, and compares unfavorably to the 12.07% return experienced by Moody's 10 Integrated Gas Companies and the 14.15% return experienced by Moody's 10 Natural Gas Transmission Companies in 1973. Staff's exhibit shows Consolidated's partial recovery: its return reached 9.3% in 1974.[37] Staff again attributed these low returns to Consolidated's low financial risk as indicated by its higher common equity ratio, its rising after-tax interest coverage (from 2.5 in 1973 to 2.7 in 1974), and its Aa bond rating by Moody's.[38] Consolidated again testified that its high equity ratio is responsible for its high bond ratings, but argued that this ratio should not be taken into consideration for purposes of determining a fair return on common equity.[39]

In Docket No. RP75-91, Consolidated introduced evidence showing that the following earnings-price ratios:

	Consolidated	Moody's 30 Natural Gas Companies	Moody's 10 Integrated Gas Companies
12 months ending June 30, 1971	9.40%	8.46%	9.59%
12 months ending Dec. 31, 1974	14.74%	16.8%	14.44%

Consolidated concluded directly from these figures that a 13.58% (or 14.0%, as originally proposed) return on common equty is justifiable.[40]

[37]Exhibit No. 32, p. 2.

[38]Exhibit No. 31, Prepared Testimony of Jack M. Adelman, at p. 10-11 and Exhibit No. 32, p. 6.

[39]Exhibit No. 30, Testimony of N. D. Davis, at p. 21. This statement is identical to that quoted above on p. 11-12.

[40]Exhibit No. 30, Testimony of N. K. Davis, at p. 15-16. In its reply comments on the settlement agreement, Consolidated contends that the return on equity cannot be less than the earnings-price ratio.

Both Staff's and Consolidated's exhibits show declining market-to-book ratios for industrials and utilities alike, including Consolidated.[41] Staff agreed that the company's price-earnings and market-to-book ratios indicated that "the market generally has not looked upon the Consolidated Natural Gas Company as favorably as the utility groups."[42] Staff pointed out that the trend indicated by Consolidated's declining price-earnings and market-tobook ratios is mitigated by similar declining trends for all compared groups. Staff emphasized that Consolidated did not experience the sharp declines in these ratios which other groups experienced. The drop in price-earnings multiples for the industrials was more significant than that experienced by Consolidated, and the decline in the company's market-to-book ratio was less pronounced than that of the major A&B pipelines. Staff further contends taht Consolidated's high equity ratio offsets the effects of its declining market-to-book ratio:

> Consolidated Natural has traditionally had a higher equity component than other utilities, giving it less leverage than is possible with a lower equity ratio. The lower leverage means a lower possibility of high returns on equity and thus the investor is unwilling to pay a high market price for Consolidated Natural's stock even though the book value coverage of the stock is high.[43]

Staff also found Consolidated's after-tax interest coverage has been consistently higher than that of each of the compared utility groups from 1970 to 1974.[44] The

[41]Exhibit No. 2, Tables 31 and 32; exhibit No. 32, p. 5

[42]Exhibit No. 31, Testimony of Jack M. Adelman, at p. 14; Exhibit No. 32, at p. 4-5.

[43]Staff's initial comments on proposed settlement agreement, at p. 12.

[44]Exhibit No. 32, at p. 6.

company's low leverage and strong after-tax interest coverage account for its Aa bond rating by Moody's.

As in Docket No. RP73-107 and Docket No. RP74-90, Consolidated supported its proposed rate of return upon the dividend yield plus anticipated growth formula. Consolidated calculated that the "sum of the dividend yield of 8.81% and the rate of earnings growth of 4.58% for the period 1964-1974 together with the 10% cost factor gives an indicated cost of equity capital to Consolidated Natural Gas Company of 14.9%."[45] In its initial comments to the settlement agreement Consolidated introduced statistical studies in support of the "conventional dividend yield plus dividend growth rate" method of determing a fair rate of return.[46] Consolidated concludes that it requires a minimum rate of return of 15.34% to maintain its historical 61.4% pay-out ratio, which is the ration of dividends paid to the earnings realized.[47]

In a thorough analysis of this extra-record data, Staff discusses the deficiencies and inconsistencies found in Consolidated study. The Commission finds it unnecessary to reiterate Staff's cogent criticism of this data in view of the fact that Consolidated's data are beyond the record. The Commission has consistently disallowed the last-minute introduction of debatable testimony or exhibits,[48] and will do so here.

[45]Exhibit No. 30, Testimony of N. K. Davis, pp. 12.15; Exhibit No. 2, Table 27.

[46]Initial comments of Consolidated Gas Supply Company, Appendix B.

[47]*Ibid. at 10.*

[48]*Pennsylvania Electric Company*, Docket No. E-8446, Opinion No. 739-A, issued on October 5, 1976.

The Commission does not dispute the fact that inflationary trends in the nation's economy have boosted the cost of capital. The threat of curtailment has increased risks for the company as well as its investors. The natural gas industry as a whole has suffered on the stock market: declining market-to-book and price-earnings ratios are being experienced on an industry-wide basis. While Consolidated exhibits the same characteristics as the utilities market in general, its ratios have not declined as significantly as other utility groups. Furthermore, the company has maintained its Aa bond ratings and high after-tax interest coverage.

The Commision has moved away from the use of the earnings-price ratio as a strict guideline in determining a fair rate of return. As pointed out by Consolidated in its reply comments, the earnings-price ratio has been used in calculating a fair rate of return.[49] The Commission's policy in this matter has evolved to include several methodologies in ariving at a decision, including the comparable earnings and the discounted cash flow methods.[50] These methods offer a broader spectrum of market conditions as they relate to regulated and unregulated industries and to the applicant in particular.

In consideration of Staff's comparable earnings approach as well as Consolidated's dividend yield plus growth method, and in light of the extensive record and comments presented in Docket No. RP75-91, the Commission finds Staff's recommendation of rate of return on common equity in the range of 11.63% (allowed

[49]*Natural Gas Pipeline Company of America*, 40 FPC 81 (1968).

[50]See, for example, Docket No. 762 and Opinion No. 769, *supra.*

Consolidated in Docket No. RP71-77) to 12.00% (allowed in Docket No. RP73-107 and RP74-90), as well as the 12.25% to 12.3% range recommended by PSNY, to be unreasonably low. Consolidated's proposed 13.58% return on equity, founded principally upon its price-earnings ratio and its dividend yield method, based primarily upon extra-record evidence, is on the high side of the zone of reasonabless. The Commsision finds a rate of return on common equity in the range of 12.0% to 12.50% to be reasonable. The Commission accordingly establishes 12.30% as a fair return on equity, with a 9.83% overall rate of return.

4.Refund Liability.

RG&E, PSNY, and NYE&G rightfully contend that by establishing the cost of service levels in these proceedings and thereby determining the company's refund liability in this order, the Commission will be unable to rectify any inequities it may find in Consolidated's cost allocation and rate design. As stated by NYE&G,

> [s]hould the Commission decide, when the issues are presented to it, to change the allocation of costs and the rate design strucutre of Consolidated, acceptance of this settlement proposal would effectively preclude it from going

[51]

	Capitalization Ratio	*Annual Cost*	*Weighted Cost*
Long Term Debt	*44.43%*	*6.84%*	*3.04%*
Preferred Stock	*3.52*	*10.96*	*.39*
Common Equity	*52.05*	*12.30*	*6.40*
	100.00%		*9.83%*

> beyond the refund level provided therein. Consolidated would not be able to retroactively collect revenues from customers which the Commission might decide had paid too little. The only alternative would be for Consolidated to absorb the underpayments, but this would be precluded since Consolidated's refund liability would be circumscribed. .... [T]he refund limitations set forth in the settlement proposal, at least in the last docket where Consolidated was fully apprised of the continuing opposition to its allocation and design theories, would be unfair to customers otherwise entitled to refunds.[52]

In support of NYE&G's argument, PSNY pointed out that Consolidated's exposure to refund liability would be greater than that set forth in the settlement agreement if the Commission later decides to decrease costs allocated to some zones by an amount greater than the "excess revenues" indicated in the settlement agreement, and increase costs allocated to others. In that event, the Commission would be unauthorized under the Natural Gas Act to order a retroactive increase in the rates for customers in zones to which the Commission has allocated greater costs.

RG&E suggest that, in its order approving the settlement agreement, the Commission should refuse to determine the question as to whether Consolidated will have refund liability in excess of that resulting from this cost of service settlement. RG&E recommends that the Commission should withhold its decision as to

[52]NYE&G Initial Comments, at 3-4.

Consolidated's refund liability until the final resolution of the cost allocation and rate design issues.

The Commission hereby adopts RG&E's recommendations. Although the Commmission has held that changes in zone cost allocation should be prospective only,[53] the Commission finds a ruling on this matter to be premature and irrelevant to the settlement of cost of service issues.

The Commission further finds:

(1) The Applicant, Consolidated Gas Supply Corporation, is a "natural gas company" subject to the provisions of the Natural Gas Act, and the sales of natural gas subject to the order which follows as a part of this decision are sales of natural gas in interstate commerce for resale subject to the jurisdiction of the Commission.

(2) It is necessary and proper in the administration of the Natural Gas Act to accept the proposed Stipulation and Agreement tendered in these proceedings subject to the conditions hereinabove described.

(3) Applicant's rates, which have been in effect in this docket subject to refund, have not been shown to be just and reasonable or otherwise lawful under the provision of the Natural Gas Act in the respects noted above, and Applicant should therefore be required to file tariff sheets reflecting just and reasonable rates as necessary to conform to this order.

[53] *Texas Eastern Transmission Corporation, Docket No. 74-41, Order issued on January 26, 1976; Cities Service Gas Company,* Docket No. RP74-4, Order Granting Relief Sought and Denied by Prior Commission Order, issued on February 2, 1976.

The Commission orders:

(A) The Stipulation and Agreement certified to the Commission in this proceeding is hereby accepted subject to the conditions as hereinabove described.

(B) Within sixty (60) days of the issuance of this order, Consolidated shall file with the Commission any necessary revisions to its cost of service and tariff sheets in conformance with the terms of the settlement agreement approved herein and reflecting the conditions described in the body of this order.

By the Commission.

(S E A L)

Kenneth F. Plumb
Secretary

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Consolidated Gas Supply Corporation) Docket Nos. RP73-107, RP74-90 and RP75-91

ERRATA NOTICE
(August 8, 1977)

ORDER APPROVING SETTLEMENT AGREEMENT SUBJECT TO CONDITIONS AND PRESCRIBING REASONABLE RATE OF RETURN
(Issued July 5, 1977)

Delete the following phrase from the seventh line in the last paragraph on page 20:

(allowed in Docket No. RP73-107 and RP74-90)

Kenneth F. Plumb,
Secretary.

UNITED STATES OF AMERICA
FEDERAL POWER COMMISSION

Before Commissioners: Charles B. Curtis, Chairman; Don S. Smith, and Georgiana Sheldon.

Consolidated Gas Supply Corporation)	Docket Nos. RP-73-107. RP74-90, and RP75-91

ORDER GRANTING IN PART AND DENYING IN PART APPLICATION FOR REHEARING

(Issued August 29, 1977)

On August 1, 1977, Consolidated Gas Supply Corporation (Consolidated) sought rehearing and reconsideration of the Commission's Order Approving Settlement Agreement Subject to Conditions and Prescribing Reasonable Rate of Return issued in these proceedings on July 5, 1977. Consolidated seeks clarification of one paragraph of the Commission's order and applies for rehearing and reconsideration of those rulings in that portion of the order providing for an 11.75% rate of return on common equity in Docket Nos. RP73-107 and RP74-90 and for a 12.30% rate of return on common equity in Docket No. RP75-91. Should the Commission deny rehearing of the rate of return issue, Consolidated requests a hearing of the issue before an Administrative Law Judge in Docket No. RP75-91.

Consolidated seeks clarification of the following paragraph in the Commission's order of July 5, 1977, at pages 20-21:

> In consideration of Staff's comparable earnings approach as well as Consolidated's dividend yield plus growth method, and in light of the extensive record and comments presented in Docket No. RP75-91, the Commission finds Staff's recommendation of rate of return on common equity in the range of 11.63% (allowed Consolidated in Docket No. RP71-77) to 12.00% (allowed in Docket No. RP73-107 and RP74-90), as well as the 12.25% to 12.3% range recommended by PSNY, to be unreasonably low. Consolidated's proposed 13.58% return on equity, founded principally upon its price-earnings ratio and its dividend yield is on the high side of the zone of reasonableness. The Commission finds a rate of return on common equity in the range of 12.0% to 12.50% to be reasonable. The Commission accordingly establishes 12.30% as a fair return on equity, with a 9.83% overall rate of return in Docket No. RP75-91. (Footnote omitted).

Consolidated stated that the designation of 12.00% as the rate of return on common equity "allowed in Docket No. RP73-107 and RP74-90" is in error. The Company's point is well taken. The Commission allowed an 11.75% rate of return on common equity in Docket Nos. RP73-107 and RP74-90. In an Errata Notice issued in these proceedings on August 8, 1977, the Commission's Secretary deleted the phrase" (allowed in Docket No. RP73-107 and RP74-90)" from the Commission's order.

Consolidated next points out that the Commission's finding in the above cited paragraph of "the 12.25% to

12.3% range recommended by PSNY to be unreasonably low" is inconsistent with the Commission's ultimate finding that a 12.3% rate of return is just and reasonable, based on the record in Docket No. RP75-91. The Commission erred. The range proposed by PSNY is not unreasonably low based upon the limited record set forth in that docketed proceeding.

Consolidated next argues that the allowance of an 11.75% return on common equity in Docket No. RP73-107 and RP74-90, and of a 12.30% return on common equity in Docket No. RP75-91, conflict with the findings in Opinion No. 811.[1] The rationale for the Commission's decision was fully delineated in Opinion No. 811 and need not be reiterated here. In short, the Commission determined that the numerous risks facing Pacific Gas Transmission Company (PGT), which purchases its total supply of natural gas from Canadian sources, PGT's need for additional capital, the inflationary trends in capital since PGT's previous rate filing, and a comparison of PGT with comparable investment alternatives warranted an increase in the allowed return on common equity to 13.0%.

In *Pacific Gas Transmission*, the Commission Staff noted that PGT's common equity ratio had increased from 28.9% in 1969 and 34.9% in 1970, to 46% in 1974. In 1970, Commission allowed PGT an 11.64% return on common equity in Docket No. RP70-4.[2] The Commission took note

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[1] *Pacific Gas Transmission Company*, Docket No. RP75-57, Opinion No. 811 issued on July 8, 1977.

[2] *Pacific Gas Transmission Company*, Docket No. RP70-4, Opinion No. 579, 43 FPC 837 (1970).

of Staff's comment on this phenomenon. "Because of this reduced percentage of debt in its capitalization, Staff reasoned that PGT has become financially more secure."[3] In the final analysis , however, PGT's common equity ratio in Docket No. RP75-57 was found to be 38.36%.[4] A finding of a 13.00% rate of return on common equity for PGT was consistent with the Commission's findings in Opinion No. 762,[5] in which Natural Gas Pipeline Company of America (Natural) was allotted a 13.5% return on equity on its 36.38% equity ratio, and Opinion No. 769,[6] in which Tennessee Gas Pipeline Company (Tennessee) was allowed a 13.69% return on equity, with an equity ratio of 37.09%. While the Commission's decisions on these equity return levels were predicated on several factors,"a key factor in supporting the equity return levels in the *Natural* and *Tennessee* cases, however, was the lower equity ratios for those companies," as noted by the Commission in the *Consolidated* order presently before us.[7]

[3]Opinion No. 811, mimeo at 14.

[4]Staff's analysis failed to consider the drop down to 38.36% in PGT's equity ratio. While an equity ratio of 46% in 1974 may have shown some stability for PGT in 1974, that was not the company's common equity ratio as found by presiding Administrative Law Judge and the Commission. It should again be noted that PGT's common equity ratio was one of many factors to be considered in Opinion No. 811. In effect, PGT was found to be less financially secure than Consolidated.

[5]*Natural Gas Pipeline Company of America*, Docket No. RP74-96, Opinion No. 762, issued on May 21, 1976.

[6]*Tennessee Gas Pipeline Company*, Docket No. RP73-113, Opinion No. 769 isued on July 9, 1976.

[7]Mimeo, at 13.

The Commission disagrees that the returns on equity allowed Consolidated are inconsistent with Commission precedent on this issue. As stated in Opinion No. 811,

> The over-all cost of capital to a corporation is logically a weighted average of the costs of the various components of that corporation's capital structure represented by the different securities instruments marketed: stocks, bonds, bank loans, etc. To neglect the weight of any one of these components, then, can only result in a miscalculation. As a practical matter such neglect when the weight is very minute can have negligible results; but when the weight of any component becomes a sizable proportion of the total, its neglect cannot be justified.[8]

Consolidated's high equity ratios of 51.94% in Docket Nos. RP73-107 and RP74-90 and of 52.05% in Docket No. RP75-90 cannot be ignored, as Consolidated will have the Commission do.[9]

It is important to note that the Commission took several factors, including inflation,[10] into consideration in

[8]Opinion No. 811, mimeo at 4.

[9]The company argued that its common equity ratio has no direct relationship to the allowance of return on common equity. See order issued on July 5, 1976 in these proceedings, mimeo at 11-12 and 17.

[10]Consolidated alleges that the Commission failed to consider the impact of inflation on the Consolidated system. Consolidated's testimony concerning the inflationary trends in capital was fully discussed in the Commission's order at 10 and 16. At page 20 of the Commission's order, the Commission stated that it "does not dispute the fact that inflationary trends in the nation's economy have boosted the cost of capital." The decision is therefore not inconsistent with the Commission's order in *Transwestern Pipeline Company*, Docket No. RP75-74, Order Accepting Settlement Agreement and Remanding Rate of Return, issued on July 19, 1977, on this matter as alleged by Consolidated (Application for Rehearing, at 7.)

determining just and reasonable levels of return on common equity for Consolidated. The company's high equity ratios served merely as one basis of comparison with alternative investment risks. While Consolidated states that "in no instance has the Commission imposed a return on equity as low as the return determined for Consolidated in this proceeding,"[11] in no instance did any rate applicant have as high a common equity ratio as Consolidated.

Consolidated takes the Commission to task only on the returns allowed on common equity. Consolidated fails to notice that its overall rates of return of 9.33% allowed in Docket Nos. RP73-107 and RP74-90 and 9.83% allowed in Docket No. RP75-91 are entirely consistent with overall return levels allowed pipelines in general, even though the embedded cost of debt in all three dockts is lower than the embedded costs of debt of most major pipelines during the locked-in periods considered. In Opinion No. 811, the Commission allowed PGT an overall return of 9.10%. In Docket Nos. RP74-48 and RP75-3, the Commission approved a settlement agreement providing for overall rates of return of 9.18% and 9.28% in the respective dockets.[12] In the *Transwestern Pipeline Company* decision which Consolidated claims is incompatible with the underlying order here, the Commission allowed the company a 9.75% overall rate of return. The Commission determined that an overall return of 9.66% was just and reasonable for Natural in Docket No. RP74-96,[13] while Tennessee was allotted an overall return of 9.25% in Docket No. Rp73-110.[14] The

[11]Consolidated submitted Appendix A, showing the rates of return allowed and common equity ratios for companies in recent Commission opinions, along with its Application for Rehearing.

[12]*Transcontinental Gas Pipe Line Company*, Docket Nos. RP74-48 and RP75-3, Order Approving Setlement with Conditions, issued on November 13, 1975.

Commission allowed Consolidated slightly higher overall rates of return that these pipelines during basically the same periods covered by these locked-in proceedings.

Consolidated next argues that the Commission failed to consider record evidence concerning the company's studies on dividend yield plus the rate of earnings growth. The Commission in its order[15] noted all three studies, which the company's witness testified were not conclusive. The Commission correctly stated that Consolidated did not place much credence in its statistics, since its proposed rates of return were unrelated to the results of its studies:

	Consolidated's Proposed Return on Equity (Settlement Agreement)	Return on Equity Recommended In DCF Statistical Analysis
Docket No. RP73-107	12.00%	14.6% (Tr. 73.)
Docket No. RP74-90	12.25%	14.9% (Tr. 95.)
Docket No. RR75-91	13.58%	14.9% (Exhibit No. 30, Testimony of N.K. Davis, at 12.15.)

[13]Opinion No. 762, *supra*.

[14]Opinion No. 769, *supra*.

[15]Mimeo at 13 and 18-19.

The Commission did consider Consolidated's studies in making its decision. However, both the Commission and Consolidated determined that returns on equity substantially lower than those recommended in the studies were justifiable.[16].

In Appendix B attached to its initial comments to the settlement agreement, Consolidated set forth certain dividend yield plus divident growth studies which were based on an statitics and data found nowhere in the record for Docket Nos. RP73-107, RP74-90 or RP75-91, as certified to the Commission by Administrative Law Judge Grossman on August 10, 1976. In its initial comments on the settlement agreement, Staff protested the submittal of this extra-record data, since it was "presented for the first time in this proceeding . . . as support for [Consolidated's] recommended rate of return."[17] In its application for rehearing, Consolidated admits that the data were not record evidence: "[t]he studies referred to in Consolidated's comments were taken from its rebuttal exhibits and would

[16]While the Commission has issued in Docket No. RM77-1 a notice of proposed rulemaking to consider dividend yield plus dividend growth studies in future rate proceedings, no final Commission rule or regulation has been issued as yet. The Commission, as well as parties to proceedings before the Commission, are not bound by the suggestions in the notice. In according Consolidated's study the same weight as the company itself, the Commission has not made its rulemaking "suspect," as alleged by Consolidated. (Application for Rehearing, at 11.))

[17]Initial Comments of Staff on Proposed Settlement Agreement, filed in these proceeding on September 20, 1976, at 13.

have been introduced into the record in a hearing."[18] Consolidated could have introduced the exhibits into the record on August 6, 1976; when Consolidated placed its testimony and exhibits along with the settlement agreement into the record during the prehearing conference held before Judge Grossman in Docket No. RP75-91. The Commission did not err in refusing to consider this extra-record data. Reconsideration of this decision is accordingly denied.

Consolidated further seeks rehearing of the Commission's decision on the grounds that the Commission ignored the Comparable earnings and capital attraction standards established in *FPC* v *Hope Natural Gas Company*.[19] The Commission fully analyzed and carefully weighed testimony sponsored by Consolidated and Staff comparing the company's returns on common equity, its equity ratios, its earnings-price ratios, and its market-to-book ratios with those of comparable investment alternatives available on the market.[20] On each

[18]Application for Rehearing at 10.

[19]320 U.S. 591 (1944). Consolidated contends that "[a]t no place in the Commission order does the Commission present any reasoned analysis of the comparable earnings test." (Application for Rehearing at 11-12.) The company's statement may be characterized as accurate only if one ignores pages 11 through 14 and 16 through 21 of the Commission's opinion.

[20]As stated by the *Hope* Court, "[u]nder the statutory standard of "just and reasonable" it is the result reached, not the method employed, which is controlling." (320 U.S. at 602.) The Supreme Court again upheld the Commission's flexibility in ratemaking matters in *Wisconsin* v. *FPC*: "It has repeatedly been stated that no single method need be followed by the Commission in considering the justness and reasonableness of rates." (373 U.S. 294, 309 (1963.)

basis of comparison, Staff presented cogent criticism of Consolidated's exhibits and analysis, and showed that the market trends indicated by Consolidated's data were mitigated by other factors affecting Consolidated. Staff's testimony, which Consolidated would have the Commission ignore, updated Consolidated's data and put it into perspective. In its statement that "Consolidated submits that the Staff's recommendation herein . . . appears to have greatly influenced the Commission,"[21] Consolidated disregards the Commission's findings that the company be allowed higher return levels than those recommended by Staff, in order to attract the capital needed by Consolidated to maintain service at a just and reasonable profit.[22]

The Commission accordingly denies Consolidated's request for rehearing of the return levels determined to be just and reasonable, on the basis of the record before us and the allegations set forth in Consolidated's application. The Commission shall remand to the presiding Administrative Law Judge the issue of rate of return in Docket No. RP75-91, for the purposes of admitting additional testimony and cross-examining witnesses.[23] Following the Initial Decision, the Commission will review the entire record in prescribing the appropriate rate of return in Docket No. RP75-91.

The Commission also deems it proper to stay the issuance of refunds in Docket No. RP75-91, as ordered in Opinion No. 819, until the final determination of the issue of rate of return in Docket No. RP75-91.

[21]Application for Rehearing, at 12.

[22]The Commission noted Consolidated's capital requirements at pages 9-10 and 15-16 of its order.

[23]The Commission notes that, if the parties had gone to hearing on this matter rather than submitting a contested settlement prematurely to the Commission, this matter would probably by now be ripe for Commission decision.

The Commission finds:

(1) Consolidated's application for rehearing of the Commission's order issued on July 5, 1977 in these proceedings should be granted in part and denied in part, in accordance with the terms and conditions of this order.

(2) A hearing on the issue of rate of return in Docket No. RP75-91 should be remanded to the presiding Administrative Law Judge.

(3) Refunds ordered by Opinion No. 819 in Docket No. RP75-91 should be stayed until the final determination of rate of return issue in Docket No. RP75-91.

The Commission orders:

(A) Consolidated's application for rehearing of the Commission's order issued on July 5, 1977 in these proceedings is hereby granted in part and denied in part, in accordance with the terms and conditions of this order.

(B) The issue of rate of return in Docket No. RP75-91 is hereby remanded to the Presiding Administrative Law Judge for the admission of evidence and cross-examination of witnesses. The Presiding Administrative Law Judge is directed to convene a pre-hearing conference no later than fifteen (15) days after the issuance of this order, to determine a schedule for the filing of testimony and for a hearing on the limited reserved issue of rate of return.

(C) The Commission hereby stays the issuance of refunds ordered in Docket No. RP75-91, as ordered by

Opinion No. 819 in these proceedings, until the final determination of the rate of return issue in that docket.

By the Commission.

(S E A L)

Kenneth F. Plumb,
Secretary.

APPENDIX C

Relevant Statutory Provisions

Title Page

Natural Gas Act, Sections 4 and 19
(15 USC §§ 717c and 717r) A-66

Rules of Practice and Procedure, Federal Energy Regulatory Commission, Sections 1.18 and 1.30
(18 CFR § and 1.40 (1979)) A-72

§ 717c. Rates and charges; schedules; suspension of new rates

(a) All rates and charges made, demanded, or received by any natural-gas company for or in connection with the transportation or sale of natural gas subject to the jurisdiction of the Commission and all rules and regulations affecting or pertaining to such rates or charges, shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

(b) No natural-gas company shall, with respect to any transportation or sale of natural gas subject to the jurisdiction of the Commission, (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

(c) Under such rules and regulations as the Commission may prescribe, every natural-gas company shall file with the Commission, within such time (not less than sixty days from the date this Act takes effect [June 21, 1938]) and in such form as the Commission may designate, and shall keep open in convenient form and place for public inspection, schedules showing all rates and charges for any transportation or sale subject to the jurisdiction of the Commission, and the classifications, practices, and regulations affecting such rates and charges, together with all contracts which in any manner affect or relate to such rates, charges, classifications, and services.

(d) Unless the Commission otherwise orders, no change shall be made by any natural-gas company in any such rate, charge, classification, or service, or in any rule, regulation, or contract relating thereto, except after thirty days' notice to the Commission and to the public. Such notice shall be given by filing with the Commission and keeping open for public inspection new schedules stating plainly the change or changes to be made in the schedule or schedules then in force and the time when the change or changes will go into effect. The Commission, for good cause shown, may allow changes to take effect without requiring the thirty days' notice herein provided for by an order specifying the changes so to be made and the time when they shall take effect and the manner in which they shall be filed and published.

(e) Whenever any such new schedule is filed the Commision shall have authority either upon complaint of any State, municipality, State commission, or gas distributing company, or upon its own initiative without complaint, at once, and if it so orders, without answer or formal pleading by the natural-gas company, but upon reasonable notice, to enter upon a hearing concerning the lawfulness of such rate, charge, classification, or service; and, pending such hearing and the decision thereon, the Commission, upon filing with such schedules and delivering to the natural-gas company affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such schedule and defer the use of such rate, charge, classification, or service, but not for a longer period than five months beyond the time when it would

otherwise go into effect; and after full hearings, either completed before or after the rate, charge, classification, or service goes into effect, the Commission may make such orders with reference thereto as would be proper in a proceeding initiated after it had become effective. If the proceeding has not been concluded and an order made at the expiration of the suspension period, on motion of the natural-gas company making the filing, the proposed change of rate, charge, classification, or service shall go into effect. Where increased rates or charges are thus made effective, the Commission may, by order, require the natural-gas company to furnish a bond, to be approved by the Commission, to refund any amounts ordered by the Commission, to keep accurate accounts in detail of all amounts received by reason of such increase, specifying by whom and in whose behalf such amounts were paid, and, upon completion of the hearing and decision, to order such natural-gas company to refund, with interest, the portion of such increased rates or charges by its decision found not justified. At any hearing involving a rate or charge sought to be increased, the burden of proof to show that the increased rate or charge is just and reasonable shall be upon the natural-gas company, and the Commission shall give to the hearing and decision of such questions preference over other questions pending before it and decide the same as speedily as possible.

§ 717r. Rehearings; court review of orders

(a) Any person, State, municipality, or State commission aggrieved by an order issued by the Commission in a proceeding under this Act [15 U.S.C. §§ 717 *et seq.*] to which such person, State, municipality, or State commission as a party may apply for a rehearing within thirty days after the issuance of such order. The application for rehearing shall set forth specifically the ground or grounds upon which such application is based. Upon such application the Commission shall have power to grant or deny rehearing or to abrogate or modify its order without further hearing. Unless the Commission acts upon the application for rehearing within thirty days after it is filed, such application may be deemed to have been denied. No proceeding to review any order of the Commission shall be brought by any person unless such person shall have made application to the Commission for a rehearing thereon. Until the record in a proceeding shall have been filed in a court of appeals, as provided in subsection (b), the Commission may at any time, upon reasonable notice and in such manner as it shall deem proper, modify or set aside, in whole or in part, any finding or order made or issued by it under the provisions of this Act [15 U.S.C. §§ 717 *et seq.*].

(b) Any party to a proceeding under this Act [15 U.S.C. §§ 717 et seq.] aggrieved by an order issued by the Commission in such proceeding may obtain a review of such order in the [circuit] court of appeals of the United States for any circuit wherein the natural-gas company to which the order relates is located or has its

principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the order of the Commission upon the application for rehearing, a written petition praying that the order of the Commission be modified or set aside in whole or in part. A copy of such petition shall forthwith be transmitted by the clerk of the court to any member of the Commission and thereupon the Commission shall file with the court the record upon which the order complained of was entered, as provided in section 2112 of title 28, United States Code. Upon the filing of such petition such court shall have jurisdiction, which upon the filing of the record with it shall be exclusive, to affirm, modify, or set aside such order in whole or in part. No objection to the order of the Commission shall be considered by the court unless such objection shall have been urged before the Commission in the application for rehearing unless there is reasonable ground for failure so to do. The finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive. If any party shall apply to the court for leave to adduce additional evidence, and shall show to the satisfaction of the court that such additional evidence is material and that there were reasonable grounds for failure to adduce such evidence in the proceedings before the Commission, the court may order such additional evidence to be taken before the Commission and to be adduced upon th ehearing in such manner and upon such terms and conditions as to the court may seem proper. The Commission may modify its findings as to the facts by the reason of the additional evidence so taken, and it shall file with the court such modified or new findings, which if supported by substantial

evidence, shall be conclusive, and its recommendations, if any, for the modification or setting aside of the original order. The judgment and decree of the court, affirming, modifying, or setting aside, in whole or in part, any such order of the Commission, shall be final, subject to review by the Supreme Court of the United States upon certiorari or certification as provided in sections 239 and 240 of the Judicial Code, as emended.

(c) The filing of an application for rehearing under subsection (a) shall not, unless specifically ordered by the Commission, operate as a stay of the Commission's order. The commencement of proceedings under subsection (b) of this section shall not, unless specifically ordered by the court, operate as a stay of the Commission's order.

(June 21, 1938, c. 556, § 19, 52 Stat, 831; Aug. 28, 1958, P. l., 85-791, § 19, 72 Stat. 947.)

§ 1.18 Conferences; offers of settlement.

(a) *To adjust or settle proceedings.* In order to provide opportunity for the submission and consideration of facts, arguments, offers of settlement, or proposals of adjustment, for settlement of a proceedings, or any of the issues therein, or consideration of means by which the conduct of the hearing may be facilitated and the disposition of the proceeding expedited, conferences between the parties to the proceeding and staff for such purposes may be held at any time prior to or during such hearings before the Commission or the officer designated to preside thereat as time, the nature of the proceeding, and the public interest may permit.

(b) *To expedite hearings.* At such prehearing or other conferences as may be held to expedite the orderly conduct and disposition of any hearing, there may be considered, in addition to any offers of settlement or proposals of adjustment, the possibility of the following:

(1) The simplification of the issues;

(2) The exchange and accceptance of service of exhibits proposed to be offered in evidence;

(3) The obtaining of admission as to, or stipualtions of, facts not remaining in dispute, or the authenticity of documents which might properly shorten the hearing;

(4) The limitation of the number of expert witnesses;

(5) Such other matters as may properly be dealt with to aid in expediting the orderly conduct and disposition of the proceeding.

(c) *Initiation of conferences.* The Commission or officer designated to preside, with or without motion, and after consideration of the probability of beneficial results to be derived therefrom, may direct that a

conference be held, and direct the parties to the proceeding, their attorneys, the Commission's staff and staff counsel to appear thereat to consider any or all of the matters enumerated in paragraph (b) of this section. Due notice of the time and place of such conference will be given to all parties to the proceeding, their attorneys, the Commisison's staff, and staff counsel. All parties will be expected to come to the conference fully prepared for a useful discussion of all problems involved in the proceedings, both procedural and substantive, and fully authorized to make commitments with respect thereto. Such preparation should include, among other things, advance study of all relevant material, and advance informal communication between the parties, including requests for additional data and information to the extent it appears feasible and desirable. Failure of a party to attend such conference, after being served with due notice of the time and place thereof, shall constitute a waiver of all objections to the agreements reached, if any, and any order or ruling with respect thereto.

(d) *Administrative law judge's authority at conference.* The administrative law judge at such conference may dispose of by ruling, irrespective of the consent of the parties, any procedural matters which he is authorized to rule upon during the course of the proceeding, and which it appears may appropriately and usefully be disposed of at that stage. In addition, where it appears that the proceeding would be substantially expedited by distribution of proposed exhibits and written prepared testimony reasonably in advance of the hearing session, the administrative law judge at his discretion and with due regard for the convenience and necessity of the parties or their attorneys, the Commission's staff or staff counsel, may

direct such advance distribution by a prescribed date. The administrative law judge's rulings made at such conference shall control the subsequent course of the hearing, unless modified for good cause shown.

(e) *Offers of settlement.* Nothing contained in this section shall be construed as precluding any party to a proceeding from submitting at any time offers of settlement or proposals of adjustment to all parties and to the Commission (or to staff counsel for transmittal to the Commission), or from requesting conferences for such purpose. Unaccepted proposals of settlement or of adjustment or as to procedure to be followed and proposed stipulations not agreed to shall be privileged and shall not be admissible in evidence against any counsel or person claiming such privilege.

(f) *Refusal to make admissions or stipulate.* If a party attending a conference convened pursuant to this section refuses to admit or stipulate the genuineness of any documents or the truth of any matters of fact and if the party requesting the admissions or stipulation thereafter proves the genuiness of any such document or the truth of any such matter of fact, he may apply to the officer designated to preside for an order requiring the other party to pay him the reasonable expenses incurred in making such proof, including reasonable attorney's fees. Unless the officer designated to preside finds that there were good reasons for the refusal to admit to stipualte or that the admissions or stipulations sought were of no substantial importance, the order shall be made. An appeal may be taken to the Commission immediately from any such order. If a party refuses to comply with

such order after it becomes final, the Commission may strike all or any part of such party's pleadings or limit or deny further participation by such party.

[Order 141, 12 FR 8477, Dec. 19, 1947, as amended by Order 217, 24 FR 9472, Nov. 25, 1959; Order 373, 33 FR 17174, Nov. 20, 1968]

§ 1.30 Decisions

(a) *Initial decisions by presiding officers.* In proceedings in which the Commission has not presided at the reception of evidence, except as otherwise provided in this part, the presiding officer, as soon as practicable after the conclusion of the hearing and expiration of the time for filing of briefs, shall certify and file with the Secretary, for the Commission, a copy of the record of the hearing, including his report thereon. Except as otherwise provided, such presiding officer's report shall constitute the initial decision, which shall be served upon all parties, or their attorneys of record, and staff counsel, who may file exceptions in the manner and within the time provided in § 1.31.

(b) *Recommended or tentative decisions.* In proceedings in which, prior to the filing of the presiding officer's report, the Commission, with notice to the parties, directs (in specific cases or by general rule) the certification to it of the record for decision by the Commission, unless otherwise provided, the presiding officer's report shall constitute a recommended decision, except that in rule making or determining applications for initial licenses, in lieu thereof, (1) the Commission may designate any of its responsible officers to recommend a decision, or (2) the Commission may issue a tentative decision. Such recommended or tentative decision shall be served upon all parties, or their attorneys of record, and staff counsel, who may file exceptions in the manner and within the time provided § 1.31.

(c) *Waiver and omission of intermediate decision procedure.* (1) In lieu of any intermediate decision

(initial by presiding officer, recommended by presiding officer or designated responsible officer, or tentative by the Commission), any party or staff counsel in any proceeding may request that the Commission forthwith render the final decision; and if all other parties and staff counsel join or concur in such request, it shall be deemed to have been granted unless the Commission denies such request within 10 days next following its submission or filing. In such requests for omitting the intermediate decision procedure there shall be specified:

(i) The concurrence of the other parties and staff counsel;

(ii) Whether opportunity for presenting oral argument or filing briefs before the presiding officer or Commission is desired or waived;

(iii) Whether opportunity for presenting proposed findings and conclusions with supporting reasons therefor, is desired or waived; and

(iv) Whether the parties reserve only their rights to apply to the Commission for rehearing and to petition for judicial review of the Commission's decision or order as may be provided for by the statute under which the proceeding was initiated and conducted.

(2) In rule-making or initial licensing proceedings the Commission, with or without request or motion therefor, may render the decision upon a finding on the record that due and timely execution of its functions imperatively and unavoidably so requires.

(3) Requests for waiver and omission of the intermediate decision procedure shall be by motion filed with the Commission at any time during, but not later than five days next following, the conclusion or adjournment sine die of the hearing; shall be in writing

under oath, subscribed and verified; and shall in all other respects conform to the requirements of §§ 1.12 and 1.15 to 1.17, inclusive: *Provided, however,* that during sessions of hearings in proceedings, motions for such waiver and omission may be made orally on the record before the presiding officer, who shall forthwith report the same to the Commission.

(d) *Final decisions.* All decisions of the Commission shall be final (subject only to application for rehearing provided for by the statute under which the proceeding is initiated and conducted), except tentative decisions that may be issued in rule-making or determining applications for initial licenses as herein provided. Final decisions shall include:

(1) Decisions by the Commission in proceedings in which the Commission has presided at the reception of evidence;

(2) Decisions upon appeal of intermediate decisions to the Commission by the parties or staff counsel, by filing exception in the manner and time provided by § 1.31, or upon review initiated by the Commission within 10 days next following the expiration of the time for filing exceptions under the aforesaid section, or such other time as the Commission may fix in specific cases;

(3) Intermediate initial or tentative decisions, upon the expiration of the time provided for an appeal to or review by the Commission without such appeal or review having been initiated;

(4) Decisions by the Commission in rule-making, or initial licensing proceedings, in which the Commission omits the intermediate decision procedure upon a finding that due and timely execution of its functions imperatively and unavoidable so requires;

(5) Decisions by the Commission in proceedings in which the intermediate decision procedure has been omitted in accordance with paragraph (c)(1) and (3) of this section;

(6) Decisions by the Commission in shortened proceedings as provided in § 1.32.

(e) *Rehearing only of final decisions.* No application for rehearing, provided for by the statute under which a proceedings is initiated and conducted, will be entertained by the Commission until a decision is issued and becomes final under the provisions of this section.

(f) *No participation by investigative or prosecuting officers.* In any proceeding in which a Commission adjudication is made after hearing, no officer, employee, or agent assigned to work upon the investigation or trial of the proceeding or to assist in the trial thereof, shall, in that or any factually related proceeding, participate or advise as to the findings, conclusions or decision, except as a witness or counsel in public proceedings.

(g) *Contents.* All decisions shall include a statement of (1) findings and conclusions, as well as the reasons or basis therefor, upon all the material issues of fact, law, or discretion presented on the record, and (2) the appropriate rule, order, sanction, relief, or denial thereof. There shall be stated all facts officially noticed pursuant to § 1.26, relied upon in the decision.

(h) *Part of record.* All decisions (including initial, recommended, or tentative decisions) shall become a part of the record.

(i) *Service.* All decisions shall be filed with the Secretary who shall serve copies thereof upon all parties or their attorneys of record, including staff counsel, whose appearances have been entered pursuant to §

1.20(e). Such service shall be by mail or by delivery to the parties or their attorneys, as may be appropriate, in accordance with § 1.17.

(j) *Unavailability of presiding officer.* If a presiding officer becomes unavailable to the Commission, the Commission with either designate another qualified officer to report and recommend the decision or will cause the record to be certified to it for decision, as may be deemed appropriate, giving notice to the parties or their attorneys of record.

(k) *Application of section.* This section shall apply in all proceedings required by statute to be determined on the record after opportunity for hearing.

[Order 141, 12 FR 8481, Dec. 19, 1947, as amended by Order 175, 19 FR 5213, Aug 18, 1954; Order 479, 38 FR 9294, Apr. 13, 1973]